Supreme Court, U. S.
FILED
NOV 7 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO INCORPORATED (formerly The American Smelting and Refining Company), *Appellant,*

v.

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee.*

On Appeal from the Supreme Court of Montana

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of the State of Montana is reported as *Montana Department of Revenue* v. *American Smelting & Refining Company,* 567 P.2d 901 (Mont. 1977). Included as Appendix A are copies of that opinion, the Supreme Court of Montana's denial of a petition for rehearing, and the unreported findings of fact and opinions of the District Court for the First Judicial District of the State of Montana (the "State District Court") and the State Tax Appeals Board of the State of Montana (the "State Tax Board").

JURISDICTION

This proceeding involves the application of Montana's corporate license tax to income earned from sources outside Montana by Appellant and six of its subsidiaries. As described more fully below, the State Tax Board and the State District Court sustained Appellant's position, but were reversed on appeal by the Montana Supreme Court which denied Appellant's petition for rehearing in an order filed on August 11, 1977 (App. A, p. 18a).[1] Included as Appendix B is a copy of the judgment against Appellant which was entered by the State District Court on August 18, 1977 in conformity with the decision of the Montana Supreme Court. Included as Appendix C are copies of the notice of appeal which Appellant filed in the State District Court on October 5, 1977, and the notice of appeal which Appellant filed in the Montana Supreme Court on October 6, 1977.

For the reasons discussed at pp. 8-10 below, this Court has jurisdiction of this appeal under 28 U.S.C. Section 1257(2); *Street* v. *New York,* 394 U.S. 576, 581-585 (1969); and *Williams* v. *Georgia,* 349 U.S. 375, 382-383, 389 (1955).

STATUTE AND REGULATIONS INVOLVED

Section 84-1503 of the Revised Codes of Montana (the "RCM") as in effect for the years 1967 through 1970 (1933 Mont. Laws Ch. 166, § 3, as amended by 1957 Mont. Laws Ch. 219, § 1) and Chapter 10 of the

[1] The pages of the eight appendices to this statement have been separately bound and consecutively numbered. References to a particular appendix will be followed by a page number indicating the location of the cited material in the appendices as a whole.

Regulations of the Department of Revenue of the State of Montana are set forth in Appendix D hereto.

QUESTIONS PRESENTED

(1) Whether the State of Montana may lawfully impose a tax pursuant to an audit conducted by agents of the Multistate Tax Commission acting under the purported authority of the Multistate Tax Compact, the consitutionality of which is now at issue in this Court in *United States Steel Corp.* v. *Multistate Tax Commission,* Dkt. No. 76-635, prob. juris. noted, 429 U.S. 1088 (1977).

(2) Whether the State of Montana may, consistently with the Commerce Clause of Article I, Section 8 of the Constitution of the United States and the Due Process Clause of the 14th Amendment to the Constitution, subject a corporation which is doing business in Montana, but is domiciled elsewhere, to a license tax on investment income of the corporation which is earned outside Montana and has no connection with the business conducted in Montana.

(3) Whether, consistently with the above-cited provisions of the Constitution of the United States, the State of Montana may impose a license tax which has the practical effect of subjecting a corporation doing business in Montana to tax on the income of its United States and foreign subsidiaries where the subsidiaries admittedly conduct no business in Montana and derive all of their income from sources outside Montana.

STATEMENT OF THE CASE

ASARCO Incorporated, the Appellant in this proceeding, is a corporation organized and existing under

the laws of New Jersey. It has its headquarters or "commercial domicile" in the State of New York, and is qualified to do business in Montana. Appellant is engaged in the business of mining, smelting, refining, manufacturing, buying and selling nonferrous metals and other minerals. In addition, Appellant derives income in the form of dividends, interest, rents, patent royalties, mine royalties, and gains from the sale of stock and other assets. Appellant has a number of wholly-owned domestic and foreign subsidiaries including Federated Metals Canada Limited, Asarco Mercantile Company, Enthone, Incorporated, International Metal Company, Lone Star Lead Construction Corp., and Northern Peru Mining Corporation. None of the named subsidiaries conducts any business or derives any income in or related to the State of Montana. (App. A, pp. 2a, 20a-22a, 24a).

Appellant owns and operates a lead smelter in East Helena, Montana, where it receives and refines lead ores and concentrates from its own mines and those of unrelated suppliers. The partially refined metal is shipped outside of Montana for further processing and sale. Appellant also owns certain active and inactive mining properties in Montana. Appellant sells by-products of its smelter operation in Montana and also has a small number of sales in Montana from unrelated operations. (App. A, pp. 3a, 22a).

In filing its Montana corporation license tax returns for 1967-1970, the years at issue herein, Appellant apportioned its *operating* business income between sources within and without Montana on the basis of a three-factor formula prescribed pursuant to RCM Section 84-1503, which attributed to Montana that fraction of Appellant's total business income which was the aver-

age of the fractions of Appellant's total tangible property, payroll, and sales attributable to Montana. Appellant believed that its *investment* income from mine royalties, patents, copyrights, rents, interest, dividends and gains from sales of assets, to the extent derived from sources outside Montana, was not subject to apportionment and was therefore not taxable in Montana under RCM Section 84-1503. Accordingly, instead of apportioning its investment income among Montana and the other states, Appellant allocated each item of such income to a particular state. All income from securities deposited with Montana State agencies and from money on deposit in Montana was allocated to Montana. All of Appellant's remaining dividend and interest income, together with all of its patent and copyright royalty income, was allocated to New York, the state of Appellant's commercial domicile. Finally, Appellant allocated rents and royalties from real property to the state in which such property was situated, and it allocated gains from the sale of tangible property to the states where the sales occurred. (App. A, pp. 3a-5a, 22a-23a).

An audit of Appellant's returns was conducted by agents of the Multistate Tax Commission. (App. A, pp. 2a, 22a). Based on that audit, the Department of Revenue of the State of Montana (referred to hereinafter as the "Department" or "Appellee") determined that *all* of Appellant's income was "business" income within the meaning of Mont. Dept. of Revenue Regulation 1001. Accordingly, the Department determined that *all* of such income had to be apportioned under the three-factor formula instead of being allocated to specific sources. (App. A, pp. 6a, 23a). By apportioning all of Appellant's out-of-state investment income, the Department arrived at a figure for Montana taxable

income which was eleven times greater than the Montana income reported by Appellant. See Brief of the Department in the Montana Supreme Court, pp. 11-12, reproduced in Appendix E hereto, pp. 60a-61a. Appellant protested the resulting proposed deficiencies and requested a hearing before the Department. (App. F, p. 64a).

In its protest to the Department, Appellant asserted that:

(1) "the proposed deficiency assessments . . . are based upon audits, studies, formulae and factors adopted by the Multistate Tax Commission, which said Multistate Tax Compact is void and illegal by reason of conflict with Article I, Section 10, Clause 3 of the Constitution of the United States" (App. F, p. 66a);

(2) "the proposed deficiency assessment . . . constitutes an illegal and unlawful attempt to impose corporation license tax upon income having no relationship to the Montana activities or the value of the privilege of doing business in Montana of and by this Taxpayer and has no reasonable relationship to corporate activities within the State of Montana conducted by Taxpayer; and constitutes an illegal and unlawful attempt to impose a corporation license tax upon income from interest, dividends, royalties, rentals and the sale of capital assets not arising from transactions or activities in the regular course of Taxpayer's trade or business or the corporate activities of Taxpayer within the State of Montana" (App. F, pp. 65a-66a);

(3) "not only has there been an attempt to allocate unitary income, but also income of a dual or multiform nature and upon a basis which does not recognize the actual activities in furtherance of the business of the Taxpayer" (App. F, p. 69a); and

(4) "the illegal and unlawful attempt by the Corporation Tax Bureau to apportion to the State of Montana income as aforesaid constitutes an illegal and unlawful burden upon interstate commerce" (App. F, p. 69a).

A hearing was held before the Department, an agreed statement of facts was entered into the record, and certain exhibits and testimony were introduced. The Department concluded that Appellant had underpaid its license tax for the years 1967-1970. On appeal, both the State Tax Board and the State District Court held in favor of Appellant on the ground that the Department's tax assessments were not authorized by statute. Accordingly, the issues relating to the constitutionality of the statute as applied to Appellant, although contained in its protest and made a part of the record, were not reached by either the State Tax Board or the State District Court. Following its defeat in the State District Court, the Department appealed to the Supreme Court of Montana which reversed the State District Court on statutory grounds. (App. A, pp. 1a-17a).

In a timely petition for rehearing, the relevant portion of which is reproduced in Appendix G, Appellant requested the Supreme Court of Montana to consider the substantial federal constitutional questions which had been raised by Appellant in its original protest, but had not been considered by the State Tax Board or the District Court because judgment had been rendered for Appellant on statutory grounds. The Department resisted the petition for rehearing primarily on the procedural ground that the constitutional issues had not previously been briefed or argued, but also on the substantive ground that Appellant's constitutional con-

tentions lacked merit. A copy of the relevant portions of the Department's response is reproduced in Appendix H. The Montana Supreme Court denied the petition "for the reasons stated in . . . [the Department's] objections to respondent's petition for rehearing." (App. A, p. 18a).

This appeal followed in due course.

REASONS FOR NOTING JURISDICTION

The constitutional issues in this case are properly before this Court, and they involve substantial federal questions.

(1) *Jurisdictional Status:* Appellant raised the constitutional issues in this case at the earliest possible opportunity by including them in the formal protest which Appellant filed with the Department. Because the State Tax Board and the State District Court both proceeded to rule in Appellant's favor on statutory grounds, it was unnecessary, and would have been improper under Montana practice, for either the Board or the District Court to consider the constitutional issues. See *State ex rel. Hammond* v. *Hager,* 160 Mont. 391, 503 P.2d 52, 57 (1972). When the Montana Supreme Court reversed and upheld the Department's statutory contentions, Appellant promptly and unequivocally requested the State Supreme Court to give consideration to those reserved constitutional issues. (See App. G, pp. 71a-77a).

The fact that this request was made in a petition for rehearing, rather than in the original briefs in the State Supreme Court, is clearly not material. The Montana rule is that a constitutional issue which is potentially decisive may be raised at *any* time and *must* be

considered by the State Supreme Court *whenever* raised. See *In re Clark's Estate,* 105 Mont. 401, 74 P.2d 401, 114 A.L.R. 496 (1937), where the Montana Supreme Court held that "a constitutional question . . . may be raised for the first time in this court" and "[w]henever that question is presented and urged" it *"must be decided"* because any other course would constitute "avoiding the performance of a duty." 74 P.2d at 406 (emphasis supplied).[2]

Because the Montana Supreme Court has a self-imposed "duty" to consider the merits of a constitutional argument regardless of when it is raised, that Court's rejection of Appellant's petition for rehearing in the present case *must* be viewed as a rejection of Appellant's constitutional arguments on substantive rather than procedural grounds. The constitutional issues are, therefore, properly before this Court. Cf. *Street* v. *New York,* 394 U.S. 576, 581-585 (1969); *Williams* v. *Georgia,* 349 U.S. 375, 382-383, 389 (1955).

In state tax cases of this type, this Court is generally the *only* federal court which has jurisdiction to review the state court's determination. See *Tully* v. *Griffin, Inc.,* 429 U.S. 68 (1976). Accordingly, a taxpayer will ordinarily be left with no remedy at all if this Court declines on jurisdictional grounds to hear appeals of cases like the present one where the state

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[2] The Department's assertion below (App. H, pp. 78a-80a) that new issues may not be raised in a petition for rehearing in the Montana Supreme Court applies only to non-constitutional issues raised by an appellant. See *Mares* v. *Mares,* 60 Mont. 36, 199 P.267 (1921). The *Mares* decision has no application whatever to *constitutional* issues raised in a petition for rehearing by an *appellee.* As shown by the subsequent decision in the *Clark* case cited in the text, issues of a constitutional nature may be raised at *any* time by *any* party, including the Montana Supreme Court itself.

court has failed to provide a clear explanation of its substantive reasons for rejecting the taxpayer's constitutional arguments. If this Court regards such cases as not ripe for review here, the appropriate course would be to note probable jurisdiction and immediately remand to the state court with a request that it clarify its position on the merits of the constitutional issues.

(2) *The Federal Questions:* This appeal involves three fundamental questions relating to the proper functioning of state income tax laws in the federal system as defined and limited by the Constitution. All three questions arise as a result of a recent movement on the part of a number of states—particularly in the West—to utilize the resources and taxing theories of the Multistate Tax Commission in order to expand the scope of the state taxing power far beyond its traditional limits in an understandable effort to raise new revenues. Compare, e.g., Dexter, Taxation of Income from Intangibles of Multistate-Multinational Corporations, 29 Vand. L. Rev. 401, 407 (1976), with Garrison, Toward A Consensus on Apportionable vs. Allocable Income, 28 Tax Exec. 41 (1975), and Peters, State Income Tax Problems of Interstate Business, 33 N.Y.U. Inst. on Fed. Tax. 899, 915 et seq. (1975).

(a) *The Role of the Multistate Tax Commission:* The audit in this case was conducted by agents of the Multistate Tax Commission (the "MTC") acting under the purported authority of the Multistate Tax Compact (App. A, pp. 2a, 22a, 41a). The constitutionality of that Compact is now at issue in *United States Steel Corp.* v. *Multistate Tax Commission, supra,* which was argued on the merits before this Court on October 11, 1977. If this Court concludes that the Compact is invalid under the Federal Constitution, a serious federal

question will arise regarding the validity of any state tax assessments resulting from audits, recommendations and arguments of MTC personnel.

The decision in the *U.S. Steel* case will clearly apply to the parties to this proceeding because Appellant is a member of the class of plaintiffs in the *U.S. Steel* case, and Montana's Commissioner to the MTC is a named defendant.

Furthermore, it is clear from the record that the MTC has played a significant role in the present case. The letter notifying Appellant of the audit adjustments stated they were "based on an audit by the Multistate Tax Commission" and, in fact, the papers containing the adjustments are headed "MULTISTATE TAX COMMISSION—INCOME TAX AUDIT—FOR STATE OF Montana". The Montana official who signed that letter testified that he worked on the audit for a short time with the MTC auditor "under his supervision and direction".[3] In both of the Montana Courts, the Department was represented by Mr. Theodore W. de Looze, an active member of MTC who was brought in from Oregon to argue the case.[4] In addition, the MTC's Chief Counsel, Mr. William D. Dexter, appeared for the MTC as amicus curiae.[5]

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[3] Transcript of Hearing Before the Department, October 1, 1973, p. 54.

[4] While the record below does not disclose Mr. de Looze's connection with the MTC, it is a matter of public record of which this Court may take judicial notice. See Eighth Annual Report, Multistate Tax Commission, for the Fiscal Year Ending June 30, 1975 at pp. xiii and 8.

[5] In the proceedings below, Appellant filed a brief in opposition to the MTC's motion for leave to participate in this proceeding as amicus curiae. Appellee has characterized a portion of Appellant's

In view of the MTC's extensive involvement in this case, the present appeal should clearly remain on this Court's docket until the Court has decided the *U.S. Steel* case and the impact of that decision can be determined.

(b) *Taxation of Out-of-State Investment Income:* There is a well-established distinction between the powers of domiciliary and nondomiciliary states to tax corporate investment income. The state in which a corporation is domiciled may tax all of its investment income regardless of source. See, e.g. *Chestnut Securities Co.* v. *Oklahoma Tax Commissioner,* 125 F.2d 571 (10th Cir.), *cert. denied,* 316 U.S. 668 (1942). However, a nondomiciliary state is not permitted to tax *any* income of an out-of-state corporation unless that income is "properly apportioned to local activities within the taxing State." *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 452 (1959). It is not claimed that Montana was Appellant's domicile. Accordingly, Montana may tax Appellant's income only to the extent that it is fairly attributable to Appellant's business within Montana. It should be emphasized that the issue here is not whether the mechanical formula applied by Montana provides a sufficiently accurate approximation of Appellant's *operating* income from Montana; Appellant itself used the three-factor formula in apportioning its total operating income between Montana and other sources. The issue

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legal argument in that brief as an admission by Appellant that MTC participation was irrelevant. (See App. H, pp. 80a-81a). What Appellee has overlooked is that the Court below *granted* MTC's motion to participate in this case, necessarily rejecting Appellant's contrary argument. The plain fact of the matter is that MTC personnel have controlled this case from the outset.

is whether Montana may apportion to itself a fraction of Appellant's *investment* income which was demonstrably derived from sources outside the State and was severable from Appellant's in-State operations.

The passive income which Appellee sought to apportion to Montana included income from intangible assets, including dividends, interest, and patent and copyright royalties; income from the sale or exchange of stock and other intangible assets; and rents and royalties from real property. With minor exceptions this income was earned and received, and the related assets were issued, held, and sold entirely outside Montana. In its tax returns, Appellant allocated entirely to Montana the income from funds and securities actually on deposit in Montana. The remaining income (hereinafter referred to for convenience as the "Investment Income") was allocated to other states. The State Tax Board and the State District Court each found as a fact that all of Appellant's Investment Income was derived from sources outside of Montana and could be "segregated" from Montana. (App. A, pp. 23a, 43a). These factual findings were not questioned in any way by the Montana Supreme Court. However, that Court held that part of each item of Appellant's Investment Income could be apportioned to Montana "without regard to [its] source". (App. A, p. 9a).

The effect of apportioning the out-of-state Investment Income was to increase dramatically the amount of Appellant's total income which Montana apportioned to itself, from a four-year total of $588,456 (as reported by Appellant) to $6,472,776 (computed without the effect of combined reporting). See App. E, pp. 60a-61a.

This gross disparity—representing an eleven-fold increase in Appellant's tax liability—is clear proof that the Montana statute as applied by the State Supreme Court "operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction". *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell,* 283 U.S. 123, 134 (1931).

It is well established that a statute which is theoretically fair on its face becomes unconstitutional if the statute as actually applied has the practical effect of taxing income or property which the state may not constitutionally reach. *American Oil Co.* v. *Neill,* 380 U.S. 451, 458 (1965); *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell, supra.* The present case involves statutory provisions which are perfectly reasonable on their face; as amplified by the regulations, they call for apportionment of "business" income among the states where the taxpayer does business, and specific allocation of the taxpayer's remaining income to the particular states where the income was earned. (See App. D, pp. 51a-58a). The problem arises because the Multistate Tax Commission auditors, the Department and the State Supreme Court labeled Appellant's passive Investment Income as "business" income in order to bring it under the apportionment provisions. If sustained, this action would have the practical effect of imposing Montana tax on part of the Investment Income, even though *all* of that Income was earned from sources *outside* Montana. In short, the tax would reach "extraterritorial values", which is a result not permitted by the Constitution. *Butler Bros.* v. *McColgan,* 315 U.S. 501, 507 (1942). See also *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U.S. 77, 80-81 (1938), holding that "the due

process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere" and *Norfolk & Western Ry. Co.* v. *Missouri State Tax Commission,* 390 U.S. 317, 325 (1968), holding that "A State will not be permitted, under the shelter of an imprecise allocation formula or by ignoring the pecularities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders.'"

It is no answer to the jurisdictional argument to say, as the State Supreme Court tried to do (App. A, pp. 11a-13a), that out-of-state investments may contribute in some vague or indirect manner to the earning of in-state operating income. Even if this were so, and the connection were direct and substantial enough to sustain an assertion of jurisdiction, this argument at best would support an allocation of income *away* from the state of operations to the investment situs, on the ground that the operating income was earned in part by the investment assets. On the other hand, all functions necessary to earn the Appellant's passive income—the holding and management of the investments—were performed outside Montana. *No* contribution was made by Appellant's Montana operations to these functions, unless it be contended that some of the invested funds were originally derived from those operations. It is inconceivable, however, that Montana could reach out to tax the investment income on funds originally earned *and already taxed* in the State, but subsequently removed and invested *elsewhere.* Similarly, the fact that such income might later be brought into and benefit in-State operations provides no support for a *present* tax on that income. Such income is clearly within the taxing jurisdiction of the state in which it is derived, and to permit another nondomi-

ciliary state to tax it as well would foster multiple taxation in contravention of due process requirements. It would also burden interstate commerce to an impermissible degree. *People ex rel. Alpha Portland Cement Co.* v. *Knapp,* 230 N.Y. 48, 129 N.E. 202 (1920) per Cardozo, J. See *Square D Co.* v. *Kentucky Board of Tax Appeals,* 415 S.W. 2d 594 (Ky. 1967); *F. W. Woolworth Co.* v. *Director of Division of Taxation,* 45 N.J. 466, 213 A.2d 1 (1965); *Gulf Oil Corp.* v. *Clayton,* 267 N.C. 15, 147 S.E. 2d 522 (1966); *American Bakeries Co.* v. *Johnson,* 259 N.C. 419, 131 S.E. 2d 1 (1963); *Commonwealth* v. *ACF Industries, Inc.,* 441 Pa. 129, 271 A.2d 273 (1970). See also *Gwin, White & Prince, Inc.* v. *Henneford,* 305 U.S. 434, 439-440 (1939).

As indicated by the cited cases, a number of state courts have held that the Constitution prevents the states from taxing out-of-state investment income earned by corporations doing business within the state. However, because this Court has not yet spoken out on the issue, the Court below apparently felt that it was free to reach a different result. The decision below is erroneous, and because it conflicts with other state court decisions on an important constitutional issue, this Court should step in to resolve the conflict. As matters now stand, the decision below is a clear inducement to other states to expand their own taxing systems beyond permissible constitutional limits.

(c) *Taxation of the Income of Out-of-State Subsidiaries:* The Department determined and the State Supreme Court held that Appellant's Montana tax liability should be computed by applying the three-factor apportionment fraction to the combined income of Appellant and six of its United States and foreign

subsidiaries. This combined calculation presents the same important federal question which is now before this Court in *Chase Brass & Copper Co.* v. *Franchise Tax Board,* 70 Cal. App. 3d 547, 138 Cal. Rep. 901 (1977) (U.S. Sup. Ct. Dkt. No. 77-582). Simply stated, the question is whether a state may impose an indirect tax on the income of companies beyond its jurisdiction, by "combining" them with affiliated companies over which it does have jurisdiction. It is Appellant's position that such an imposition constitutes both an impermissible burden on interstate and foreign commerce and a denial of due process of law.

It is undisputed that the six subsidiaries in question had insufficient contacts with Montana to be subject to its taxing jurisdiction. See Brief of the Department in the Montana Supreme Court, at pp. 48-49, reproduced in App. E, p. 62a. No contention has been raised that Appellant understated its Montana income, or its business income, by failing to deal at arm's length with these companies. The Department did not invoke the provisions of § 84-1508, RCM, which provides explicit authority to adjust distortions in separate income arising as a result of affiliation. The combined subsidiaries had no direct or indirect dealings with Appellant's Montana operations. Finally, the State District Court found that Appellant's income could be determined without reference to the income of the combined subsidiaries (App. A, p. 24a), and this finding was not overturned by the Montana Supreme Court.

On this record, there is no justification for the State Supreme Court's conclusion that combined reporting was a proper method of determining *Appellant's* Montana income. A parent and its wholly-owned subsidiary

are separate taxable entities for federal tax purposes. *National Carbide Corp.* v. *Commissioner,* 336 U.S. 422 (1949); *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590 (1943). They are no less so for state tax purposes. To the extent combined reporting produces an increase in Montana's definition of taxable "income", Appellant is not in fact being taxed on the income of its Montana operations but rather on an arbitrarily assigned amount of its subsidiaries' income. *Square D Co.* v. *Kentucky Board of Tax Appeals, supra; Gulf Oil Corp.* v. *Clayton, supra; Universal Manufacturing Corp.* v. *Brady,* 320 So.2d 784 (Miss. 1975). Thus, Montana is levying an indirect tax on that which it could not constitutionally tax directly, and using its personal jurisdiction over Appellant's Montana operations to collect a tax which is in fact levied on income from other operations which are constitutionally beyond reach. This Court very recently reiterated the principle that it is the economic effect of a tax rather than nomenclature which determines its validity. *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977). See also *American Oil Co.* v. *Neill, supra,* 380 U.S. at 455. For two of the years in issue, the economic effect of the Montana tax as applied to Appellant is clearly to tax "extraterritorial values". *Butler Bros.* v. *McColgan, supra,* 315 U.S. at 507.[6]

Because combined reporting is becoming a pervasive practice, and is being vigorously promoted by the

[6] Because the combination of Appellant with its subsidiaries would not produce an increased taxable income for the years 1967 and 1970, it would have no unconstitutional effect in those years. See App. E, pp. 60a-61a.

MTC,[7] it is important for this Court to exercise its jurisdiction to determine whether the practice is valid, and, if so, the extent to which it may be used. The *Chase Brass* case and the present case provide an appropriate opportunity for this Court to examine the problem in two different, but representative, factual contexts.

CONCLUSION

For the foregoing reasons, this Court should note probable jurisdiction and either remand to the Montana Supreme Court for elaboration of its views on the merits of Appellant's constitutional arguments, or schedule the case for plenary consideration by this Court.

Respectfully submitted,

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GEORGE W. BEATTY
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Counsel for Appellant

[7] See, e.g., *Coca Cola Company* v. *Department of Revenue,* 271 Ore. 517, 533 P.2d 788 (1975), which was argued by the same counsel who appeared for the Department in the present case. See also Garrison, Toward A Consensus on Apportionable vs. Allocable Income, 28 Tax Exec. 41 (1975).

Supreme Court, U. S.
FILED
NOV 7 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO INCORPORATED (formerly The American Smelting and Refining Company), *Appellant,*

v.

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee.*

On Appeal from the Supreme Court of Montana

APPENDIX

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No. 13249

IN THE SUPREME COURT OF THE STATE OF MONTANA

1977

MONTANA DEPARTMENT OF REVENUE, STATE OF MONTANA,
Petitioner and Appellant,

— vs —

THE AMERICAN SMELTING AND REFINING COMPANY,
Defendant and Respondent.

Appeal from: District Court of the First Judicial District, Honorable Peter Meloy, Judge presiding.

Counsel of Record:

For Appellant:

Terry B. Cosgrove argued, Helena, Montana
Theodore W. DeLooze argued, Salem, Oregon

For Respondent:

Hughes, Bennett and Cain, Helena, Montana
George T. Bennett argued, Helena, Montana
Charles Smith, Helena, Montana

For Amicus Curiae:

William D. Dexter appeared, Olympia, Washington

Submitted: January 27, 1977
Decided July 11, 1977

Filed: July 11, 1977

/s/ THOMAS J. KEARNEY
Thomas J. Kearney
Clerk

Mr. Chief Justice Paul G. Hatfield delivered the Opinion of the Court.

This is an appeal by the Montana Department of Revenue (DOR) from a judgment entered in the district court, Lewis and Clark County, affirming a final decision of the State Tax Appeal Board (STAB). The STAB decision ordered a recomputation of the deficiency assessment levied by DOR against American Smelting and Refining Company (ASARCO).

In 1972 the auditors of the Multistate Tax Commission conducted an audit of ASARCO's records for the tax years 1967-1970. Subsequent to this audit, additional corporation license taxes were assessed against ASARCO by DOR. The amount of this deficiency assessment is the underlying issue upon appeal.

ASARCO is a New Jersey corporation engaged in national and international operations in the business of mining, smelting, refining, manufacturing, buying and selling nonferrous metals and minerals. ASARCO basically engages in two separate, but related areas of operation. The first is a primary metal operation consisting of the mining, milling, smelting and refining of nonferrous metals. The second is a nonferrous alloy operation consisting of the manufacture and sale of alloy products.

For the tax years in question ASARCO owned mines in Colorado, Washington, Arizona, New Mexico and Idaho in addition to mines in Canada and other foreign countries. It operated smelters and refineries in Texas, Maryland, Colorado, Montana, Missouri, Arizona, Nebraska, New Jersey, Washington and California for the years in question. Alloy manufacturing plants were located in Texas, New Jersey, California, Oklahoma and Indiana. ASARCO sales offices were located in New York, Baltimore, Boston, Cincinnati, Cleveland, Detroit, Milwaukee, Philadelphia, Rochester and St. Louis.

ASARCO owns and operates a smelter in East Helena which is its principal operation in Montana. This smelter receives lead ores and concentrates from company mines as well as unrelated suppliers. The smelted, but unrefined lead product is then shipped to other units of ASARCO for further treatment and eventual sale. Anaconda Company purchased various by-products of the East Helena smelter for the years in question. In addition to the East Helena smelter ASARCO owns certain active and inactive mining properties in Montana.

Prior to 1962 ASARCO reported its income from its Montana properties by separate accounting, pursuant to section 84-1503, R.C.M. 1947. Under that method ASARCO determined the gross receipts from its Montana properties and deducted all expenses incurred by or attributable to such properties to arrive at Montana income. Where overhead expenses such as the cost of transportation were attributable to more than one state, they were apportioned to determine the Montana portion.

In 1962 ASARCO recognized that its business was unitary in nature and it could no longer use separate accounting for its income. Pursuant to section 84-1503 it requested permission from DOR to change from separate accounting to the unitary method of accounting. Permission was granted by DOR and a "hybrid" system of reporting income was instituted. Under this hybrid system, all but a negligible amount of total company income from rents, royalties, dividends, interest and sales of tangible and intangible properties was allocated to sources outside Montana. After deductions for the allocated income, ASARCO's operating net income was apportioned to Montana sources by the use of a three factor formula.

An in-depth examination of ASARCO's hybrid system indicates the following procedure was used to compute tax liability for the years in question. ASARCO classified the income listed below as nonbusiness income under

DOR's 1967 regulations, deducted it from its apportionable income, and allocated it as indicated:

(a) Income from mine royalties paid by the lessees of ASARCO's Keystone Mine previously operated by ASARCO and located in the State of Colorado was allocated to the State of Colorado;

(b) Income from patents and copyrights on items developed by ASARCO's research department and used in ASARCO's operations and licensed to others, was allocated to commercial domicile;

(c) Income from rental of housing units on mining properties and rented to employes was allocated to the state where such rental units are located:

(d) Interest income from United States obligations, customers notes and bonds, notes on the sale of a plant and General Cable stock, from state and municipal bonds, time certificates, bankers acceptances, and commercial paper was allocated to the state of commercial domicile;

(e) Gains from the sales of tangible properties were allocated to the state of sale;

(f) Dividends paid on stocks were allocated to state of commercial domicile;

(g) Gains from the sale of stock were allocated to the state of commercial domicile; and

(h) Income from securities deposited with Montana state agencies and from money deposited in Montana was allocated to Montana.

The percentage of apportionable income or loss attributable to Montana sources was calculated by the use of this formula:

$$\frac{\text{Montana property}}{\text{Total ASARCO Property}} + \frac{\text{Montana Payroll}}{\text{Total ASARCO Payroll}} + \frac{\text{Montana Sales}}{\text{Total ASARCO Sales}}$$

$$\text{Averaged by dividing by 3} = \text{____\%}$$

The percentage obtained was then multiplied by ASARCO's total apportionable income to determine the Montana contribution.

DOR contends the hybrid system used by ASARCO to calculate its Montana income incorrectly interpreted section 84-1503, R.C.M. 1947. That section at the time in question, stated:

> "If the income of any corporation from sources within the state cannot be properly segregated from income without the state, then, in that event, the amount of the net income returned shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the state of Montana bears to the total gross business of the taxpayer, and apportionment shall be made under the rules and regulations prescribed by the state board of equalization, giving consideration to sales, property and payroll and such other factors as may be deemed applicable; provided, however, that the state board of equalization shall, upon the presentation of satisfactory evidence, determine that the income from sources within the state of Montana may be properly segregated from income from sources without the state of Montana and shall allow separate accounting. The board shall publish not less than once a year, all rules and regulations pertaining to this section. All decisions by the board under this section shall be subject to judicial review in an action prosecuted by the corporation in the district court of Lewis and Clark county. The taxpayer cannot change from one method of accounting to another method of accounting without first obtaining permission from the board."

DOR interprets the above statute as creating only two methods of determining income from sources within Mon-

tana—separate accounting or apportionment of total net income. Separate accounting is available only if income from sources within the state may be segregated from sources without the state. In the absence of the above conditions, total business net income must be apportioned.

DOR determined that the income classified by ASARCO as nonbusiness income was, in fact, business income as defined by DOR's 1967 regulations. DOR therefore restored this income to apportionable net income. In addition, DOR included in apportionable net income the net income of six of ASARCO's wholly owned subsidiaries. DOR contends that ASARCO and the six subsidiary corporations were engaged in a unitary business and therefore the combination was merely an extension of the apportionment method of taxation dictated by section 84-1503.

Pursuant to DOR's calculations of ASARCO's Montana income additional corporate license taxes were assessed. Protest was made by ASARCO and a hearing was held before the director of DOR. The director's decision affirmed the deficiency assessment. Thereafter ASARCO appealed to STAB which reversed the director's decision. DOR then petitioned the district court, Lewis and Clark County, requesting a review of the STAB order. On December 17, 1975, the district court entered judgment affirming the decision of STAB. DOR appeals the district court judgment.

Three issues are before the Court upon appeal:

1) Whether DOR had the authority, pursuant to sections 84-1503 and 84-1508, R.C.M. 1947, to adopt its Regulations 1001-1020 (Chapter 10) concerning rules for the apportionment of corporate net income?

2) Whether ASARCO was correct in its deduction of alleged nonbusiness income from apportionable net income prior to apportionment?

3) Whether the income from six of ASARCO's wholly owned subsidiaries was properly included in apportionable net income?

On December 30, 1966, DOR adopted its Regulations 1001-1020 (Chapter 10). These regulations were effective with respect to tax years beginning on and after January 1, 1967. Included within these regulations are specific rules for allocation and apportionment of corporate income derived from sources both within and without Montana. In addition key terms are specifically defined as to their application to the regulations.

The regulations provide for two methods of accounting for income; apportionment according to a three-factor formula and separate accounting. Separate accounting is allowed only in situations where income can be specifically segregated as to source. Apportionment of income must be used in all other cases. The apportionment system adopts what may be categorized as a "business vs. nonbusiness" test in regard to determining what income is apportioned and what income may be allocated to source. Under this system all business income is apportioned by use of the three-factor formula while only nonbusiness income may be allocated to source. Business income is defined as all income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. Nonbusiness income is defined as all income other than business income.

ASARCO urges these regulations were ineffective as applied to it for the tax years 1967-1970 for two reasons:

1. DOR by virtue of section 84-1503 had the authority to adopt rules and regulations only as to the apportion-

ment of such income as could not be segregated as to source.

2. The regulations adopt a "business vs. nonbusiness" income test rather than the "source" of income test found in section 84-1503 and are therefore fatally inconsistent.

Any contention that DOR lacks the authority to adopt rules and regulations interpreting taxation statutes is without merit. In regard to the statute in question, the power to adopt rules and regulations is clearly and unambiguously stated within the text of the statute. Furthermore section 84-1508, R.C.M. 1947, gives DOR power to provide "such other regulations as may from time to time be found necessary." We affirmed this principle in State ex rel. Fulton v. District Court, 139 Mont. 573, 366 P.2d 435.

The crux of this entire case is the interpretation of section 84-1503 and DOR Regulations 1001-1020. There is no merit in ASARCO's contention that DOR has only authority to adopt rules and regulations for the apportionment of income incapable of segregation as to source.

The function of the Supreme Court when construing a statute is simply to ascertain and declare what is in substance stated therein, and not to insert what has been omitted or to omit what has been inserted. Dunphy v. Anaconda Co., 151 Mont. 76, 438 P.2d 660; In re Transportation of School Children, 117 Mont. 618, 161 P.2d 901; Section 93-401-15, R.C.M. 1947. The fundamental rule of statutory construction is that the intent of the legislature controls. Matter of Senate Bill No. 23, Chapter 491, Montana Session Laws of 1973, 168 Mont. 102, 540 P.2d 975, 32 St. Rep. 954; Hammill v. Young, 168 Mont. 81, 540 P.2d 971, 32 St.Rep. 935; Dunphy v. Anaconda Co., supra; Section 93-401-16, R.C.M. 1947. Where the intent of the legislature can be determined from the

plain meaning of the words used, the courts may not go further and apply any other means of interpretation. State ex rel. Huffman v. District Court, 154 Mont. 201, 461 P.2d 847; Dunphy v. Anaconda Co., supra. Here, the plain meaning of the words used by the legislature unmistakably discloses its intent. DOR clearly has the authority to adopt rules and regulations as to the apportionment of corporate income without regard to source.

There also is no merit in ASARCO's second contention. ASARCO argues that section 84-1503 contains a "source of income" test to be used in determining apportionable income vs. allocatable income. ASARCO concludes that this apparent conflict with the business vs. nonbusiness income test found in the regulations makes the regulations ineffective as applied to ASARCO. As support for its theory of inconsistency between the statute and the regulations, ASARCO points out that section 84-1503 was amended in 1974, and the amended statute conforms to the regulations.

In the construction of an amendatory act it will be presumed that the legislature, in passing it, intended to make some change in the existing law, and therefore the Court should endeavor to give effect to the amendment. Pilgeram v. Hass et al., 118 Mont. 431, 167 P.2d 339; Nichols v. School District No. 3, 87 Mont. 181, 287 P.624. However, this presumption of change is not conclusive. This Court stated in School District No. 12 v. Pondera County, 89 Mont. 342, 297 P. 498, that a change in a statute may be made merely to express more clearly the original intent of the legislature. Such is the case here. The unamended statute is not a model of clear draftmanship in regard to guidelines for the apportionment of corporate income. DOR therefore adopted Regulations 1001-1020 to provide clear guidelines for taxpayer compliance. The legislature thereafter saw fit to clarify the section by the 1974 amendment to section 84-1503. The

unamended version of section 84-1503 is not in conflict with the regulations and therefore ASARCO must report its income in compliance with those regulations.

Regarding ASARCO's second issue, we find the hybrid system of reporting income used by ASARCO to be invalid under section 84-1503. As above, the crux of this issue is the interpretation of section 84-1503 and Regulations 1001-1020. The intent of the legislature in regard to the determination of what income is apportionable income is clear and unambiguous. Section 84-1503 provides for two methods of accounting for income; separate accounting and apportionment.

Section 84-1503 provides a test for the determination of the correct method of accounting to be used by a corporation in reporting its Montana corporation license tax. If income from all sources within Montana can "be properly segregated from income without the state" then and only then, may the separate accounting method be used. Furthermore if the separate accounting method is applicable, total net income must be allocated to source rather than the hybrid system used by ASARCO.

ASARCO recognized its business was unitary in nature in 1962. It requested and was granted permission by DOR to discontinue the separate accounting system then in use. Hence both parties agree that ASARCO must apportion its income and the question becomes what income is included in apportionable net income.

The regulations are clear and simple. All business income is apportionable and nonbusiness income is allocated to source. ASARCO argues that certain items of income listed above are nonbusiness income and therefore properly deductible from apportionable net income. This contention is incorrect.

The regulations state that business income includes income derived from tangible and intangible property if the

acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operation. After an in-depth examination of the income in question, we find this income is derived from sources that are integral portions of its business. This finding is in direct conflict with the district court's finding of fact which state this income is nonbusiness income. The test of whether this income is in reality business or nonbusiness income is a matter of statutory interpretation. We feel therefore that the finding of the district court is in error. We are confronted herein with a conclusion of law, rather than a finding of fact. Listed below are examples of the relationship of this alleged nonbusiness income to ASARCO.

1) Royalty Income—The royalty income arose from two sources, mine royalties and patent royalties. The mine royalties arose when ASARCO leased its Keystone mine in Colorado to an unrelated mining concern. ASARCO had operated this mine prior to the leasing. The royalty was computed on the basis of mine production. The patent income arose from royalties paid for the use of devices developed by ASARCO's research department. These devices were developed initially for ASARCO's use in its various plants and mines. The main item included herein was a vertical feed furnace.

2) Rental Income. The majority of this income is derived from homesites rented to employees working near ASARCO mines and plants. Mr. Pecca, an ASARCO official, testified at the DOR hearing:

> "This is the, it's almost exclusively rents received from employees working at the company mines which are located in remote areas and the company is required to provide houses."

3) Interest Income—The interest income arose from customers' notes on bonds, U.S. government notes, notes

taken on the sale of a plant and stock, state and municipal bonds, and time certificates and other commercial paper. All were clearly liquid securities and were therefore readily available for use in meeting company obligations and debts.

4) Gains on the Sale of Stock—ASARCO bought and sold stock in various corporations during the years in question. Included within the sales were stock of General Cable, Revere Copper, Kennicott Copper, and Hecla Mining Company. These corporations are all engaged in the business of either producing metal ore or manufacturing the refined product into goods. The stock was used by ASARCO for business purposes, such as gaining access to raw materials or access to potential customers for its refined metals. Therefore all the above income was generated by the unitary business operation of ASARCO.

The concept of including income from the sale of tangible and intangible property and income derived from rents, royalties and interest within apportionable net income is not new nor unique. In Sperry and Hutchinson Co. v. Department of Revenue, 270 Or. 329, 527 P.2d 729, 731, short term securities held to satisfy the need for liquid capital were held to be apportionable. The Oregon court stated:

> "S & H argues that because this income is the return on an intangible it must be allocated to legal situs. Nothing in our former law requires such an arbitrary result and our current law expressly prohibits it." 527 P.2d 731.

The current law referred to by the Oregon court is in pertinent part identical to the DOR regulations here in question. A similar result dealing with short term intangibles was reached in Montgomery Ward & Co., Inc. v. Comm. of Taxation, 276 Minn. 479, 151 N.W.2d 294.

In Cleveland-Cliffs Iron Co. v. Michigan Corporation and Securities Commission, 351 Mich. 652, 88 N.W.2d 564, 572, the issue was whether an investment portfolio containing certain steel stocks should be included in determining the book net worth of the corporation. The court held the stocks were closely related to the company's business, quoting with approval from Flint v. Stone Tracy Company, 220 U.S. 107, 31 S.Ct. 342, 55 L.Ed. 389:

> "Nor can it be justly said that investments have no real relation to the business transacted by a corporation. The possession of large assets is a business advantage of great value; it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige." 88 N.W.2d 572.

See also: Great Lakes Pipe Line Co. v. Commissioner of Taxation, 272 Minn. 403, 138 N.W.2d 612.

Concerning the final issue, DOR is correct in its contention that net income and apportionment factors of six of ASARCO's wholly owned subsidiaries must be included in ASARCO's computation of apportionable net income. This is merely an extension of the unitary method of taxation. Simply stated, the traditional concept of a combination of various units of a corporation for unitary method tax computation is extended to a combination of various related or affiliated corporations.

In the instant case, the six affiliated corporations are clearly separate and distinct from ASARCO. However all are wholly owned by ASARCO and share common members of their respective boards of directors with ASARCO. A close relationship exists between ASARCO's business operation and the subsidiaries in that the sub-

sidiaries all provide ASARCO with material, services, or a market for its products. From the discussion of the individual corporation's operations listed below, it is clear the corporations are dependent upon each other and each in turn contributes to the other's business success.

1) Federated Metals of Canada—Federated Metals is a Canadian corporation which basically operates the same business in Canada as ASARCO's American operation. ASARCO provides Federated with certain central services such as operations technology and accounting and financial services. In addition, sales between the two corporations are significant.

2) ASARCO Mercantile Company—ASARCO Mercantile is engaged solely in the purchase and sale of machinery for ASARCO's subsidiaries. All central services are provided by ASARCO.

3) Enthone, Inc.—Enthone is a Connecticut corporation engaged in the manufacture and sale of metal finishing chemicals and supplies used in metal plating. About 16% of Enthone's raw materials were purchased from ASARCO. Central services were provided by ASARCO.

4) International Metal Company—This company is ASARCO's exclusive sales outlet for materials delivered to foreign countries. ASARCO provides all central services.

5) Lone Star Lead Construction Co.—Lone Star is a Texas corporation engaged in lining tanks with lead for protection against corrosive contents. The vast majority of its lead requirements are purchased from ASARCO.

6) Northern Peru Mining Co.—All production from Northern Peru's mines are sold to ASARCO and refined in its plants.

In addition to the foregoing, Mr. Pecca testified as to other services provided by ASARCO to all its subsidiaries. These include:

1. ASARCO handles central insurance of the subsidiaries.

2. Services provided by ASARCO are billed to the subsidiaries, including top management.

3. All United States and state returns are prepared by ASARCO for the subsidiaries.

4. Legal services are provided by ASARCO for the subsidiaries whenever necessary.

5. Essential capital is provided for the subsidiaries, who do not go to outside sources without first going to ASARCO.

Coca Cola Company v. Department of Revenue, 271 Or. 517, 533 P.2d 788, 790, 792, is on all fours with the instant case. There the Oregon court said:

> "The principal issue in this case is whether the income from Coca Cola and its wholly owned subsidiaries may be combined and the apportionment formula applied to the sum to determine the income properly attributable to Oregon." 533 P.2d 790.

The Oregon court first stated that in order to properly combine the incomes of the parent and subsidiary, the business operation must be unitary. The unitary test was defined as whether the business units, or in this case corporations, are dependent upon each other and contribute to the operation of the other's business. Zale-Salem, Inc. v. Tax Com., 237 Or. 261, 391 P.2d 601. Un-

questionably this test is met in the instant case. The Oregon court in *Coca Cola Company* then stated:

> "We must now decide whether the fact that Coca Cola and its wholly owned subsidiaries are organized as separate corporate entities precludes the Department of Revenue from combining their incomes to reflect the true character of their unitary business. We hold that it does not." • • •
>
> "The question is fundamentally one of whether a business should stand in a better position for purposes of determining income merely because it chooses to use a multiple corporation organizational scheme. We do not feel that it should. We agree with the following statement of the California Supreme Court:
>
> "' • • • [A]ccepting, as we must, the application of the law to unincorporated wholly controlled branches or businesses located in other jurisdictions as set forth in Butler Brothers v. McColgan, 17 Cal.2d 664, 111 P.2d 334; Id., 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991, the conclusion is irresistible that the same rule should apply to incorporated wholly controlled branches or businesses so located. • • •' Edison California Stores v. McColgan, supra at 473-74, 183 P.2d at 17."

The decision of the district court is reversed. This case is remanded to the district court with instructions to

enter judgment in favor of the Montana Department of Revenue in the amount of the original deficiency assessment.

/s/ [illegible]
Chief Justice

We concur:

/s/ GENE B. DALY
Gene B. Daly
/s/ JOHN CONWAY HARRISON
John Conway Harrison
/s/ FRANK I. HASWELL
Frank I. Haswell
/s/ DANIEL J. SHEA
Daniel J. Shea
Justices

IN THE SUPREME COURT OF THE STATE OF MONTANA

(Caption Omitted in Printing)

Order

[FILED AUGUST 11, 1977]

PER CURIAM:

Having considered respondent's petition for rehearing in the above named cause,

IT IS ORDERED that the petition for rehearing is hereby denied for the reasons stated in appellant's objections to respondent's petition for rehearing.

DATED this 10th day of August, 1977.

/s/ [ILLEGIBLE]
Chief Justice

/s/ JAMES CONWAY HARRISON

/s/ FRANK I. HASWELL

/s/ DANIEL J. SHEA

Justices

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS & CLARK.

No. 37750

MONTANA DEPARTMENT OF REVENUE, STATE OF MONTANA,
Petitioner,

vs.

THE AMERICAN SMELTING AND REFINING COMPANY,
Respondent.

Findings From the Record, Opinion, Conclusions of Law, and Judgment.

This matter constitutes a proceeding for review of a final determination of the State Tax Appeal Board of the State of Montana pursuant to Section 84-709.1 R.C.M. 1947, and with respect to the Montana Corporation License Tax liability of respondent for the years 1967, 1968, 1969 and 1970.

On the 14th day of March, 1974, the State Tax Appeal Board of the State of Montana in those certain proceedings entitled "American Smelting and Refining Company, Appellant, vs. The Department of Revenue of the State of Montana, Respondent", being No. CT-1973-17 before the State Tax Appeal Board, made and entered its Findings of Fact, Conclusions of Law, and Order.

That thereafter, and pursuant to Section 84-709.1, R.C.M. 1947, the Department of Revenue of the State of Montana, filed its Petition for proceedings for review of said Findings of Fact, Conclusions of Law and Order (herein referred to as "final decision") of said State Tax Appeal Board of the State of Montana. That said Petition for Review was filed on the 9th day of April, 1974.

That on the 16th day of May, 1974, the Department of Revenue filed its motion to present additional evidence

and a request for oral hearings and written briefs, and on the 2nd day of December, 1974, filed an Amended Petition to Present Additional Evidence.

The Department of Revenue of the State of Montana was represented in this matter by Theodore W. deLooze, Special Assistant Attorney General, admitted for the purposes of this proceeding, and Terry B. Cosgrove, Special Assistant Attorney General. The respondent, The American Smelting and Refining Company, was represented by George T. Bennett of the firm of Hughes, Bennett & Cain. The matter having been fully briefed and twice orally argued to the court, and the court having taken the application of the Department of Revenue for leave to introduce evidence under advisement, and the matter having otherwise been submitted upon the record made before the State Tax Appeal Board of the State of Montana, the Court makes the following Findings From The Record, Opinion, Conclusions of Law, and Judgment:

Findings From the Record

1. That the appellant, American Smelting and Refining Company (ASARCO), is a corporation organized and existing under the laws of the State of New Jersey, and is qualified to do and doing business in the State of Montana, and maintains its commercial domicile at 120 Broadway, New York City, New York.

2. That the appellant is engaged in the business of mining, smelting, refining, manufacturing, buying and selling non-ferrous metals and other minerals, and, in addition, receives income in the form of dividends, interest, patents, royalties, mine royalties and gains from the sale of certain properties.

3. That the following active companies are wholly owned subsidiaries of the appellant:

(a) ASARCO Developments (NZ) Ltd., a New Zealand corporation, engaged in the examination of

mining properties, principally for others, in New Zealand;

(b) ASARCO Exploration Company of Canada, Ltd., a Canadian corporation, engaged in the examination of mining properties;

(c) ASARCO (Australia) Pty., Limited, an Australian corporation, engaged in the examination of mining properties principally for others, in Australia;

(d) ASARCO International Corporation, a Delaware corporation, engaged in the sale of asbestos fibre produced by Lake Asbestos of Quebec, Ltd.;

(e) ASARCO Mercantile Company, a Texas corporation, engaged in the purchase and sale of manufactured products, principally for ASARCO and certain subsidiaries;

(f) Bolivian Lead Corporation, a New York corporation, engaged in mining in Bolivia, South America;

(g) Compania American Smelting, S.A., a Chilean corporation, engaged in the leasing of mineral rights in Chile;

(h) Enthone, Incorporated, a Connecticut corporation, engaged in the manufacture and sale of metal and other surface finishing chemicals and supplies;

(i) Federated Metals Canada Limited, a Canadian corporation, engaged in producing chemicals in Canada;

(j) International Metal Company, a New York corporation, a dealer in concentrates and metals;

(k) Lake Asbestos of Quebec, Ltd., a Delaware corporation, engaged in mining of asbestos ore and the production of asbestos fibre in Canada;

(l) Lone Star Lead Construction Corp., a New York corporation, engaged as a contractor in construction of non-ferrous tank houses; and

(m) Northern Peru Mining Corporation, a Delaware corporation, engaged in mining non-ferrous metals in Peru.

4. That appellant owns and operates a smelter in East Helena, Montana, where it receives lead ores and concentrates from company mines as well as unrelated suppliers. The appellant's East Helena, Montana, lead smelter ships the refined lead product to other units of the appellant for further treatment and ultimate sale, and sells by-products of its smelting operation. The appellant also owns in Montana active and inactive mining properties.

5. That appellant is a unitary business and files its Montana tax returns using the apportionment method.

6. That an audit was conducted of the books and records of appellant for the years 1967, 1968, 1969, and 1970, by an auditor of the Multistate Tax Commission.

7. That due to the audit conducted on the books and records of appellant that a deficiency assessment was levied against appellant for the years 1967, 1968, 1969, and 1970, in the amount of $409,145.07, of which $71,845.69 was interest, none of which has been paid.

8. That appellant reported its income for Montana Corporation License Tax purposes for the taxable years 1967 through 1970 in the following manner:

(a) Income from mine royalties consisting of the Keystone Mine in the State of Colorado was allocated to the State of Colorado;

(b) Income from patents and copyrights were allocated to commercial domicile;

(c) Income from rental of housing units on mining properties was allocated to the state where such rental units are located;

(d) Interest income was allocated to the state of commercial domicile;

(e) Gains from sales of tangible properties were allocated to the state of sale;

(f) Dividends paid on stocks were allocated to state of commercial domicile; and

(g) All other income was apportioned by the formula prescribed by Section 84-1503, R.C.M. 1947.

9. That the Corporation License Tax Bureau of the Department of Revenue, in making the deficiency assessment as set forth in Exhibit "E", included all income of the appellant, and by Federated Metals of Canada, ASARCO Mercantile Company, Enthone, Inc., International Metal Company, Lone Star Lead Construction Corp., and Northern Peru Mining Corporation; and treated all of such income as apportionable by formulae whereby there was apportioned to the State of Montana an allocated part based on the relationship between the tangible property, sales, and payroll, with respect to the Montana operation in relation to the total operations.

10. That, with the exception of securities deposited with various state agencies and monies deposited locally in the State of Montana, the income from which have been allocated to the State of Montana, all of the appellant's stocks, bonds, commercial paper and other evidences of indebtedness are located outside of the State of Montana.

11. That all of the appellant's income from mine royalties, patents, copyrights, rental, interest, dividends and gains upon sales of tangible or intangible properties, can be properly segregated as to sources within and sources without the State of Montana.

12. That the business operations conducted by the appellant and the business operations conducted by its affiliated corporations are not interrelated or interdependent to the extent that the net income of the appellant and any one or more of its affiliated corporations cannot resonably be determined without reference to the operations conducted by the other companies and that the income of the affiliated corporations has been properly reported by separate accounting.

13. That the appellant for a number of years has owned common stock of General Cable Corporation. That, pursuant to a Consent Decree entered by the United States District Court on March 15, 1967, in a proceeding commenced by the Anti-Trust Division of the Justice Department, the appellant and General Cable Corporation were enjoined from having a director or officer who was at the same time a director, officer or employee of the other, and that the appellant give a proxy covering its stock holdings to the persons designated by General Cable's board of directors prior to any stockholders' meeting. On July 24, 1970, the Consent Decree was modified to require complete divestiture by appellant of all of its common stockholdings of General Cable Corporation. Pursuant thereto, appellant did sell such stock in the taxable year 1970.

14. That this is a proper proceeding for review of the final decision of the State Tax Appeal Board of the State of Montana instituted before this Court by the filing of a Petition within thirty (30) days after service of the final decision of the State Tax Appeal Board and pursuant to Section 84-709.1, R. C. M.

15. That the issues determined by the State Tax Appeal Board of the State of Montana by its final decision on the 14th day of March, 1974, were as follows:

(a) Whether American Smelting and Refining Company, for Montana Corporation License Tax purposes

and pursuant to Sections 84-1501, et seq., R. C. M. 1947, properly reported the following items of income as being from sources without the State of Montana, viz., (1) income from mine royalties consisting of the Keystone Mine in the State of Colorado; (2) income from patents and copyrights; (3) income from rental of housing units on mining properties located outside the State of Montana; (4) interest income earned on bonds, commercial paper and other evidence of indebtedness invested, maintained and located outside the State of Montana; (5) gains from sales of properties located outside the State of Montana; and (6) dividends paid on stocks located and maintained at commercial domicile; and

(b) Whether the respondent, American Smelting and Refining Company, could be required by the Department to combine the income of Federated Metals of Canada, Asarco Mercantile Company, Enthone, Inc., International Metal Company, Lone Star Lead Construction Corp., and Northern Peru Mining Corporation, with its income and allocate the same to the State of Montana.

16. The State Tax Appeal Board of the State of Montana determined as to the first issue that for the taxable years 1967, 1968, 1969 and 1970, the respondent American Smelting and Refining Company had properly separated its income from sources within the State of Montana from income from sources without the State of Montana.

17. That as to the second issue the State Tax Appeal Board of the State of Montana determined that the business operations conducted by the respondent American Smelting and Refining Company and the business operations conducted by its affiliated corporations were not interrelated or interdependent to the extent that the net income of the respondent American Smelting and Refining Company in any one or more of its affiliated corporations could not reasonably be determined without

reference to the operations conducted by the other companies, and that the income of the affiliated corporations was properly reported by separate accounting.

18. That the respondent, Montana Department of Revenue of the State of Montana, has by its amended petition to present additional evidence, asked that the respondent American Smelting and Refining Company be required to answer certain questions with respect to its dividend, rental, royalty, interest income, and gains on sale of capital assets, the questions all being generally, whether, with respect to such income received by the taxpayer for the years listed, such income was "used in the trade or business of the company" after it had been earned or derived.

19. The Department, appellant here, has offered no reason why such proposed additional evidence was not produced at the proceedings before the Department of Revenue or before the State Tax Appeal Board and is now the subject of an application before this Court.

From the foregoing Findings From the Record, the Court makes the following:

OPINION

The respondent filed its Montana Corporation License Tax returns for the taxable years in question and thereafter the Department of Revenue, acting in conjunction with the Multi-state Tax Commission, audited such returns and made adjustments with respect thereto. It is these adjustments that are the subject of this controversy.

First, in adjusting the corporation license tax liability of the respondent for the taxable years in question, the Department made the following described adjustment to dividend income, rental income, royalty income and gains on sales of capital assets, whereas the respondent had, as to such income, reported the same as follows according to the findings of the Montana State Tax Appeal Board:

(a) Income from mine royalties consisting of the Keystone Mine in the State of Colorado was allocated to the State of Colorado;

(b) Income from patents and copyrights were allocated to commercial domicile;

(c) Income from rental of housing units on mining properties was allocated to the state where such rental units are located;

(d) Interest income was allocated to the state of commercial domicile;

(e) Gains from sales of tangible properties were allocated to the state of sale;

(f) Dividends paid on stocks were allocated to state of commercial domicile; and

(g) All other income was apportioned by the formula prescribed by Section 84-1503, R.C.M. 1947.

As to its income from investments held and maintained in Montana, the respondent treated such income as entirely earned from sources within the State of Montana and reported the income accordingly.

The Department of Revenue, purporting to act under the "principles" of the Uniform Division of Income for Tax Purposes Act, treated all of the respondent's investment income, whether earned from sources within or sources without the State of Montana, as "business income" and required the same to be apportioned between Montana and other states according to a formula based upon the ratio of sales, property and payroll within and without the State of Montana. The State Board of Equalization of the State of Montana, and predecessor to the Department of Revenue, purported to adopt on December 30, 1966, and effective with respect to taxable years beginning on and after January 1, 1967, regulations

numbered 1001, et seq., for the "allocation and apportionment of income."

The Department of Revenue contends that its predecessor had a right to adopt such regulations and that it has a right to enforce such regulations under the provisions of Section 84-1503, R.C.M. 1947.

Under the Uniform Division of Income for Tax Purposes Act, and under the regulations adopted by the prior State Board of Equalization and attempted to be enforced by the Department of Revenue, there is a distinction drawn between "businss income" and non-business income." The term "business income" is defined as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." As to rents, capital gains, interest, dividends, royalties and other similar types of investment income, if it is found to constitute non-business income it is allocated pursuant to specific allocation rules therein incorporated. Thus, as to the passive or investment income of the respondent as described by the Montana State Tax Appeal Board, the Department of Revenue contended that respondent was a unitary business within the meaning of the definition contained in Regulations 1001, et seq; that all of the income of the respondent constituted "business income"; and that, therefore, all of the passive or investment income of the respondent, whether it was clearly earned from sources within the State of Montana or clearly earned from sources without the State of Montana, was to be allocated according to the formula the factors of which are payroll, property and sales.

In this Court's opinion, Section 84-1503, R.C.M. 1947, as effective for the taxable years 1967 through 1970, in-

clusive, is controlling. Pursuant to that section, the Department of Revenue and its predecessor, the State Board of Equalization, had the authority to adopt regulations as to the apportionment of income only where it finds that such income cannot be properly segregated as to sources within or without the State. The section provided, for the taxable years in question:

> "If the income of any corporation from sources within the state cannot be properly segregated from income without the state, then, in that event, the amount of the net income returned shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the state of Montana bears to the total gross business of the taxpayer, and apportionment shall be made under the rules and regulations prescribed by the state board of equalization, giving consideration to sales, property and payroll and such other factors as may be deemed applicable; provided, however, that the state board of equalization shall, upon the presentation of satisfactory evidence, determine that the income from sources within the state of Montana may be properly segregated from income from sources without the state of Montana and shall allow separate accounting. The board shall publish not less than once a year, all rules and regulations pertaining to this section. All decisions by the board under this section shall be subject to judicial review in an action prosecuted by the corporation in the district court of Lewis and Clark county. The taxpayer cannot change from one method of accounting to another method of accounting without first obtaining permission from the board."

Under the clear and unambiguous language of this section, the taxing authorities of the State of Montana had the authority to adopt rules and regulations only as

to the apportionment of such income as could not be segregated as to source. If income could be segregated as to source, then it was allocable to that source in its entirety. Secondly, this section very clearly provides that the taxing authorities of the State of Montana must, upon the presentation of "satisfactory evidence", determine "that the income from sources within the State of Montana may be properly segregated from income from sources without the State of Montana and shall allow separate accounting". Here, the State Tax Appeal Board, by its Finding No. 10 determined:

> "That, with the exception of securities deposited with various state agencies and monies deposited locally in the State of Montana, the income from which have been allocated to the State of Montana, all of the Appellant's (Respondent's) stocks, bonds, commercial paper and other evidences of indebtedness are invested in intangibles outside of the State of Montana and all of such evidences of indebtedness are located outside of the State of Montana."

The Montana State Tax Appeal Board, by its Finding No. 11, found and determined:

> "That all of the Appellant's (Respondent's) income from mine royalties, patents, copyrights, rental, interest, dividends and gains upon sales of tangible or intangible properties, can be properly segregated as to sources within and sources without the State of Montana."

The Department of Revenue apparently does not quarrel with the Findings of the State Tax Appeal Board quoted hereinabove. To the contrary, the contention of the Department is that "source of income" is no longer the test, that the test is whether or not such income constitutes "business income" as defined in the Uniform

Division of Income for Tax Purposes Act. In this respect, this Court must point out that Section 84-1503, R. C. M. 1947, was in fact amended by Section 2, Chapter 5 of the Laws of 1974, effective as to all taxable years on and after December 31, 1973, to specifically make applicable to the Montana Corporation License Tax the provisions of the Uniform Division of Income for Tax Purposes Act, and, in addition, by Section 84-1503, R.C.M. 1947, Subsection (1)(a), a definition of unitary business. Prior to this amendment, the only definition of unitary business contained in the Montana Corporation License Tax Act was in Section 84-1509, R.C.M. 1947, with regard to affiliated corporations. The Montana Corporation License Tax Act, prior to this amendment, did not contain any definition of nor did it make any distinction between so-called "business" or "non-business" income. There is no issue before this Court as to whether or not the respondent is a unitary business under Section 84-1503, R.C.M. 1947, as amended by Section 2, Chapter 5, Laws of 1974, and effective for all taxable years on and after December 31, 1973. Very clearly the question here is the interpretation of Section 84-1503, R.C.M. 1947, prior to the 1974 amendments. Section 84-1503, R.C.M. 1947, prior to such amendments, is clear and unambiguous. It allows the taxpayer to segregate income which can be clearly identified as to source. There appears to be no question here that if this is the test that the income of the respondent which is in question here can be identified as to source. This being determinative, the decision of the Montana State Tax Appeal Board with respect thereto is correct.

In interpreting Section 84-1503, R. C. M., prior to its amendment in 1974, this Court is to ascertain and give effect to the intention of the Legislature as expressed in the statute; Section 93-401-16, R. C. M. Where the plain meaning of words used indicate the legislative in-

tent, courts may not go further and apply any other means of interpretation. State ex rel. Huffman v. District Court, 154 Mont. 201, 461 P.2d 847.

Here, the key language of Section 84-1503, as then effective, is:

> "If the income of any corporation from sources within the state cannot be properly segregated from income without the state, *then, in that event, . . .*" (Emphasis supplied.)

The "event" which triggers Section 84-1503 is where income cannot be properly segregated and this is the express holding of the Supreme Court in Montana Life Insurance Company v. Shannon, 106 Mont. 500, 78 P.2d 946, where it is said (P.504):

> "Furthermore, when the amount of gross income within the state was known and determined properly, then the principal question involved in this litigation was thereby settled. In the circumstances of this case, the Board could not properly invoke the rule of Section 2297.1 (now Section 84-1503, R. C. M. 1947) as the statute has no application here."

Additionally, the Department was required under Section 84-1503, R. C. M., as effective, to allow the taxpayer to segregate income intermingled as to source by separate accounting and upon "satisfactory" evidence that this could be done.

In contrast, the Legislature has changed this rule by its 1974 amendments to Section 84-1503, R. C. M. Under this section as amended, separate accounting is not allowed to a "unitary" business and the term "unitary" is defined in different terms from those contained in Section 84-1509, R. C. M.

In short, it would appea. that the Legislature by this amendment in 1974, has changed the rule from "source of income" to nature of income (business or non-business) and changed the rule of accounting as to unitary and non-unitary businesses.

There is a presumption that in amending an existing statute (Section 84-1503), that the legislature intended to make a change therein; State ex rel Dick Irvin, Inc., v. Anderson, (1974) —— Mont. ——, 525 P.2d 564; Montana Milk Control Brd. v. Community Creamery Company, 139 Mont. 523, 366 P.2d 151; Van Tigham v. Lennane, 136 Mont. 547, 349 P.2d 569.

Here there is more than just a presumption of change as to such statute. Here, clearly, the Legislature has shifted from the "source" rule to the "unitary" or "non-unitary" "business", "non-business" income approach. In light of this the attempt by the taxing authorities to make such a change by Regulations 1001, et seq., prior to such 1974 legislative change, was ineffective.

Turning to the second issue, the respondent, in reporting its taxable income to the State of Montana for the taxable years 1967 through and including 1970, did not include the income of any of its affiliated corporations which are not doing business within the State of Montana. The Department of Revenue in making its deficiency assessments for these years included with the income of respondent the income of Federated Metals of Canada, Asarco Mercantile Company, Enthone, Inc., International Metal Company, Lone Star Lead Construction Corp., and Northern Peru Mining Corporation, on the theory that all of these corporations were "unitary" under Regulations 1001, et seq. This income then having been deemed to be the income of the respondent was apportioned according to the formula based upon sales, property and payroll.

The Montana State Tax Appeal Board, by its Finding of Fact No. 12, found and determined:

> "That the business operations conducted by the Appellant (Respondent) and the business operations conducted by its affiliated corporations are not interrelated or interdependent to the extent that the net income of the Appellant (Respondent) and any one or more of its affiliated corporations cannot reasonably be determined without reference to the operations conducted by the other companies and that the income of the affiliated corporations has been properly reported by separate accounting."

In light of this Finding of Fact, the State Tax Appeal Board correctly determined that under Section 84-1509, R. C. M. 1947, the Department could not require the income of these affiliated corporations to be combined or consolidated with the income of the respondent.

The Department of Revenue, on the other hand, argues that Section 84-1509, R. C. M. 1947, is not the controlling statute. At page 17 of the Department's final brief in this matter, it states, commencing at Line 26:

> "In no way can Section 84-1509 be read as a statute providing for combination. The authority for combining the company and its subsidiaries is found in the case law and the Department's Regulations 1001."

The Court has examined the Department's Regulation "1001". Section 1001 of the Department's regulations speaks in all three paragraphs of "a corporation subject to this tax", or "a corporation engaged in a 'unitary' business operation within and without Montana", and "a corporation not engaged in a unitary business. . . ." In all instances, this regulation deals with a single corporation. If it was the intent of this regulations to apply to affiliated corporations, then it should have so stated. In any event,

it is the opinion of this Court that the Department of Revenue and its predecessor, the State Board of Equalization, had no authority to go beyond the clear provisions of Section 84-1509, R. C. M. 1947. The Legislature of the State of Montana having, by Section 84-1509, R. C. M. 1947, addressed itself to the problem of the combining or consolidating of income of affiliated corporations, and this section being the only section in the Montana Corporation License Tax Act which deals with affiliated corporations, it is controlling.

The express mention of one subject or authority in an act (affiliated corporations under Section 84-1509) excludes other similar matters not mentioned; Helena Valley Irrigation District v. State Highway Commission, 150 Mont. 192, 433 P. 2d 791; Reed v. Reed, 130 Mont. 409, 304 P.2d 590; Stephens v. City of Great Falls, 119 Mont. 368, 175 P.2d 408. The Court must reject the Department's contention that it can rely upon its own regulations or "case law" to come to a different requirement than that expressed in the act.

The Court has examined the "case law" as cited by the Department and such "case law" consists of cases from the State of California and the State of Oregon construing statutes of those states which are different from those contained in the Montana Corporation License Tax Act. It is the opinion of this Court that the Department of Revenue must, for the taxable years here in question, find its authority to combine or consolidate the income of affiliated corporations under the provisions of Section 84-1509, R. C. M. 1947, and the State Tax Appeal Board, having determined that this section does not require the combination or consolidation of the respondent with its affiliated corporations, its decision must be affirmed.

Lastly, the Department of Revenue has filed herein an Amended Petition to Present Additional Evidence. There has been no satisfactory reason advanced by the Depart-

ment for failure to present the evidence before the State Tax Appeal Board. (See Section 82-4216 as amended.) Additionally such evidence is irrelevant in view of this Court's opinion as to the law under which the American Smelting and Refining Company is to be taxed for the years in question.

CONCLUSIONS OF LAW

I.

That the Findings of Fact, Conclusions of Law and Order of the State Tax Appeal Board of the State of Montana so made on the 14th day of March, 1974, constituting its final decision, should be by this Court affirmed in all respects.

II.

That the application of the appellant, Department of Revenue, for leave to introduce additional evidence should be denied.

III.

That pursuant to Section 84-1503, R.C.M. as effective for the taxable years 1967, 1968, 1969 and 1970, the Department of Revenue had the authority to adopt rules and regulations only with respect to the "apportionment" of income which could not be properly segregated as to source. The Department of Revenue of the State of Montana had no authority under this section to adopt regulations which attempted to define source of income or to define unitary business or unitary operation.

IV.

That Section 84-1503, R.C.M. 1947, for the taxable years in question, required that the Department of Revenue allow a taxpayer upon satisfactory evidence to separately account for income from sources within the State of Montana and income from sources without the State of Montana.

V.

That Section 84-1509, R.C.M. 1947, is the only provision of the Corporation License Tax Act applicable for the taxable years 1967, 1968, 1969 and 1970 which contains a definition of unitary business operation or deals with the requirement of consolidated or combined returns of income between related corporations. That the definition of unitary business operation therein contained requires that one business operation be so conducted by the corporation and the affiliated group that they are interrelated or interdependent to the extent that the net income of one corporation cannot be reasonably determined without reference to the operations conducted by the other corporations.

VI.

That the State Tax Appeal Board correctly found and determined that the respondent's dividend income, rental income, royalty income and income from gains on sale of assets had been properly segregated and identified as to its source within or without Montana under Section 84-1503, R.C.M. 1947.

VII.

That the State Tax Appeal Board correctly found and determined that all of the respondent's stocks, bonds, commercial paper and other evidences of indebtedness are invested in intangibles outside of the State of Montana except as to those investments held in Montana and totally allocated to Montana, and that all of such evidences of indebtedness are located outside of the State of Montana and therefore such income having been identified as to source was properly reported by respondent.

VIII.

That the State Tax Appeal Board correctly found and determined that the business operations conducted by the respondent, American Smelting and Refining Company, and the business operations conducted by its affiliated corporations are not interrelated or interdependent to the extent that the net income of the respondent and any one or more of its affiliated corporations cannot reasonably be determined without reference to the operations conducted by the other companies and that the income of the affiliated corporations had been properly reported by separate accounting.

IX.

That the respondent, American Smelting and Refining Company, properly reported its income for the taxable years 1967, 1968, 1969 and 1970 pursuant to the appropriate provisions of the Montana Corporation License Tax Act as contained in Sections 84-1501, et seq., R.C.M. 1947.

JUDGMENT

Upon the foregoing Findings From The Record and Conclusions of Law, the Court makes the following Judgment:

IT IS HEREBY ORDERED, ADJUDGED and DECREED that the final decision of the State Tax Appeal Board of the State of Montana as contained in its "Findings of Fact, Conclusions of Law and Order", is in all respects by this Court affirmed.

Dated this 17 day of December, 1975.

/s/ PETER G. MELOY
District Judge

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

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(Caption Omitted in Printing)

Findings of Fact, Conclusions of Law, and Order

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Hearing on the appeal of AMERICAN SMELTING AND REFINING COMPANY, pursuant to Section 84-708, R.C.M. 1947, came on regularly for hearing before the Board on January 7, 1974, at 10:00 a.m., in the City of Helena, Montana, from a decision of the Department of Revenue denying Appellant's requested relief with respect to the combining or consolidating of affiliated corporations with Appellant for tax purposes and refusing to set aside the deficiency assessments levied against said Appellant based thereon and the decision of the Department of Revenue in treating all of Appellant's income, regardless of source or nature, as allocatable by formula, contrary to the Corporation License Tax Act of the State of Montana, and refusing to set aside the deficiency assessments based thereon for the taxable years 1967, 1968, 1969, and 1970; the Appellant, American Smelting and Refining Company, appearing through its attorney, George T. Bennett, Esq., of the firm of Hughes, Bennett and Cain, Helena, Montana; and the Department of Revenue being represented by Terry B. Cosgrove, Esq., Assistant Tax Counsel; and the Board having heard the testimony and having examined all of the evidence and briefs offered by all parties, and the Board being fully advised in the premises, does hereby make its Findings of Fact, Conclusions of Law and Order as follows:

FINDINGS OF FACT

1. That the Appellant, American Smelting and Refining Company (ASARCO), is a corporation organized and existing under the laws of the State of New Jersey, and is qualified to do and doing business in the State of Montana,

and maintains its commercial domicile at 120 Broadway, New York City, New York.

2. That the Appellant is engaged in the business of mining, smelting, refining, manufacturing, buying and selling non-ferrous metals and other minerals, and, in addition, receives income in the form of dividends, interest, patents, royalties, mine royalties and gains from the sale of certain properties.

3. That the following active companies are wholly owned subsidiaries of the Appellant:

(a) ASARCO Developments (NZ) Ltd., a New Zealand corporation, engaged in the examination of mining properties, principally for others, in New Zealand;

(b) ASARCO Exploration Company of Canada, Ltd., a Canadian corporation, engaged in the examination of mining properties;

(c) ASARCO (Australia) Pty., Limited, an Australian corporation, engaged in the examination of mining properties, principally for others, in Australia;

(d) ASARCO International Corporation, a Delaware corporation, engaged in the sale of asbestos fibre produced by Lake Asbestos of Quebec, Ltd.;

(e) ASARCO Mercantile Company, a Texas corporation, engaged in the purchase and sale of manufactured products, principally for ASARCO and certain subsidiaries;

(f) Bolivian Lead Corporation, a New York corporation, engaged in mining in Bolivia, South America;

(g) Compania American Smelting, S.A., a Chilean corporation, engaged in the leasing of mineral rights in Chile;

(h) Enthone, Incorporated, a Connecticut corporation, engaged in the manufacture and sale of metal and other surface finishing chemicals and supplies;

(i) Federated Metals Canada Limited, a Canadian corporation, engaged in producing chemicals in Canada;

(j) International Metal Company, a New York corporation, a dealer in concentrates and metals;

(k) Lake Asbestos of Quebec, Ltd., a Delaware corporation, engaged in mining of asbestos ore and the production of asbestos fibre in Canada;

(l) Lone Star Lead Construction Corp., a New York corporation, engaged as a contractor in construction of non-ferrous tank houses; and

(m) Northern Peru Mining Corporation, a Delaware corporation, engaged in mining non-ferrous metals in Peru.

4. That Appellant owns and operates a smelter in East Helena, Montana, where it receives lead ores and concentrates from company mines as well as unrelated suppliers. The Appellant's East Helena, Montana, lead smelter ships the refined lead product to other units of the Appellant for further treatment and ultimate sale, and sells by-products of its smelting operation. The Appellant also owns in Montana active and inactive mining properties.

5. That Appellant is a unitary business and files its Montana tax returns using the apportionment method.

6. That an audit was conducted of the books and records of Appellant for the years 1967, 1968, 1969, and 1970, by an auditor of the Multistate Tax Commission.

7. That due to the audit conducted on the books and records of Appellant that a deficiency assessment was levied against Appellant for the years 1967, 1968, 1969,

and 1970, in the amount of $409,145.07, of which $71,845.69 was interest, none of which has been paid.

8. That Appellant reported its income for Montana Corporation License Tax purposes for the taxable years 1967 through 1970 in the following manner:

(a) Income from mine royalties consisting of the Keystone Mine in the State of Colorado was allocated to the State of Colorado;

(b) Income from patents and copyrights were allocated to commercial domicile;

(c) Income from rental of housing units on mining properties was allocated to the state where such rental units are located;

(d) Interest income was allocated to the state of commercial domicile;

(e) Gains from sales of tangible properties were allocated to the state of sale;

(f) Dividends paid on stocks were allocated to state of commercial domicile; and

(g) All other income was apportioned by the formula prescribed by Section 84-1503. R.C.M. 1947.

9. That the Corporation License Tax Bureau of the Department of Revenue, in making the deficiency assessment as set forth in Exhibit "E", included all income of the Appellant, and by Federated Metals of Canada, ASARCO Mercantile Company, Enthone, Inc., International Metal Company, Lone Star Lead Construction Corp., and Northern Peru Mining Corporation; and treated all of such income as apportionable by formulae whereby there was apportioned to the State of Montana an allocated part based on the relationship between the tangible property, sales, and payroll, with respect to the Montana operation, in relation to the total operations.

10. That, with the exception of securities deposited with various state agencies and monies deposited locally in the State of Montana, the income from which have been allocated to the State of Montana, all of the Appellant's stocks, bonds, commercial paper and other evidences of indebtedness are invested in intangibles outside of the State of Montana and all of such evidences of indebtedness are located outside of the State of Montana.

11. That all of the Appellant's income from mine royalties, patents, copyrights, rental, interest, dividends and gains upon sales of tangible or intangible properties, can be properly segregated as to sources within and sources without the State of Montana.

12. That the business operations conducted by the Appellant and the business operations conducted by its affiliated corporations are not interrelated or interdependent to the extent that the net income of the Appellant and any one or more of its affiliated corporations cannot reasonably be determined without reference to the operations conducted by the other companies and that the income of the affiliated corporations has been properly reported by separate accounting.

13. That the Appellant for a number of years has owned common stock of General Cable Corporation. That, pursuant to a Consent Decree entered by the United States District Court on March 15, 1967, in a proceeding commenced by the Anti-Trust Division of the Justice Department, the Appellant and General Cable Corporation were enjoined from having a director or officer who was at the same time a director, officer or employee of the other, and that the Appellant give a proxy covering its stock holdings to the persons designated by General Cable's board of directors prior to any stockholders' meeting. On July 24, 1970, the Consent Decree was modified to require complete divestiture by Appellant of all of its common stockholdings of General Cable Corporation. Pursuant thereto, Appellant did sell such stock in the taxable year 1970.

Conclusions of Law

1. That the gain upon the sale by Appellant of its shares of common stock of General Cable Corporation was income derived from a forced sale and was not income from a sale in the regular course of Appellant's trade or business.

2. That as to those matters on appeal to this Board, the Appellant properly reported all of its income from mine royalties, patents, copyrights, rental, interest, dividends and gains upon sale of tangible or intangible properties and properly allocated such income to sources within and without the State of Montana.

3. That Appellant properly reported all of its income from its integrated mining, smelting and refining business, and properly apportioned to the State of Montana the proper portion thereof under appropriate formulae as to those matters on appeal to this Board.

4. That all Appellant's income as to those matters on appeal to this Board was properly reported, allocated and apportioned in accordance with the Montana Corporation License Tax Act effective for the taxable years in question.

5. That the Appellant cannot be required to file combined or consolidated reports with any affiliated corporation.

Order

Based on the above Findings of Fact and Conclusions of Law, It Is Hereby Ordered:

1. That the Taxpayer's appeal from the decision of the Department of Revenue is granted.

2. That the Corporation License Tax Bureau of the Department of Revenue recompute the deficiency assessment for the taxable years 1967, 1968, 1969, and 1970, in accordance with the Corporation License Tax Returns filed by

Appellant (Exhibits "A" to "D") and render a statement to the Appellant for such taxes and interest thereon to date as and for the Appellant's liability, subject, however, to the adjustments hereafter mentioned, which were ordered by the Department of Revenue following its hearing in this matter and which were not a part of this appeal:

(a) Adjustment for the value of the Block P Mine in the property factor;

(b) Adjustment for property in bonded warehouses;

(c) Adjustment for inventory in transit;

(d) Adjustment for payments of tax made by Taxpayer as a result of Federal audit; and

(e) Adjustments necessary by reason of the Federal audit for taxable year 1969.

3. Subject to the above, and subject to the 1970 Federal audit, the deficiencies for all taxable years in question are hereby set aside and vacated.

Dated this 14th day of March, 1974.

By Order of the
State Tax Appeal Board

/s/ Ray J. Wayrynen
Ray J. Wayrynen, Chairman

/s/ Helen M. Peterson
Helen M. Peterson, Member

Member J. Morley Cooper dissenting:
I dissent.

/s/ J. Morley Cooper
J. Morley Cooper, Member

Attest:

/s/ Vernon B. Miller
Vernon B. Miller, Secretary

APPENDIX B

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

MONTANA DEPARTMENT OF REVENUE, of the State of Montana, *Petitioner,*

-VS-

AMERICAN SMELTING AND REFINING COMPANY, *Respondent.*

No. 37750

Judgment on Remittitur

(Filed August 18, 1977)

THIS ACTION came on regularly for hearing before this Court, the Petitioner, Montana Department of Revenue, appeared in this matter by Theodore W. deLooze, Special Assistant Attorney General, and Terry B. Cosgrove, Special Assistant Attorney General, the Respondent, American Smelting and Refining Company appeared by its attorney, George T. Bennett of the firm of Hughes, Bennett & Cain. The matter having been fully briefed and twice orally argued to the Court, the Court entered Findings From the Record, Opinion, Conclusions of Law and Judgment, on the 17th day of December, 1975, in favor of the Respondent.

That Order was appealed to the Montana Supreme Court, after the filing of briefs and oral argument, the said Montana Supreme Court reversed the Judgment and

a Remittitur was issued by the Clerk of the Montana Supreme Court on the 11th day of August, 1977, and this Court was directed to enter Judgment in favor of the Petitioner.

WHEREFORE, by virtue of the law and by reason of the premises aforesaid, IT IS ORDERED, AJUDGED AND DECREED AND THIS DOES ORDER, AJUDGE AND DECREE that the Respondent, American Smelting and Refining Company, is ordered to pay to the Petitioner, Montana Department of Revenue, $497,776.47, plus interest, as provided by law, and that Petitioner have execution therefore.

DONE AND DATED THIS 18 OF AUGUST, 1977.

/s/ JIM C. MELOY
District Judge

APPENDIX C

IN THE DISTRICT COURT FOR THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

• • • • • •

Civil No. 37750

MONTANA DEPARTMENT OF REVENUE, STATE OF MONTANA,
Petitioner,

-VS-

ASARCO INCORPORATED (formerly THE AMERICAN SMELTING AND REFINING COMPANY), *Respondent.*

• • • • • •

Notice of Appeal to the Supreme Court of the United States

• • • • • •

Notice is hereby given that the Respondent above-named, ASARCO Incorporated (formerly The American Smeltin and Refining Company), hereby appeals to the Supreme Court of the United States from the final judgment, opinion and order of the Supreme Court of the State of Montana, reversing the judgment of the District Court of the First Judicial District, and from the order denying petition for rehearing, entered in this action on August 11, 1977.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

/s/ GEORGE T. BENNETT
George T. Bennett
Counsel for Respondent

(Affidavit Of Service Omitted In Printing)

IN THE SUPREME COURT
OF THE
STATE OF MONTANA

• • • • • •

CAUSE NO. 13249

• • • • • •

MONTANA DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA,
Petitioner and Appellant,

-VS-

ASARCO INCORPORATED (formerly THE AMERICAN SMELTING AND REFINING COMPANY),
Defendant and Respondent.

• • • • • •

Notice of Appeal to the Supreme Court of the United States

(Filed October 6, 1977)

• • • • • •

/s/ RICHARD T. CONBOY
Richard T. Conboy
Deputy Clerk of Supreme Court
Helena, Montana

Notice is hereby given that the Defendant and Respondent above-named, ASARCO Incorporated (formerly The American Smelting and Refining Company), hereby appeals to the Supreme Court of the United States from the final judgment, opinion and order of the Supreme Court of the State of Montana, reversing the judgment of the District Court of the First Judicial District, and from the order denying petition for rehearing, entered in this action on August 11, 1977.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

/s/ GEORGE T. BENNETT
George T. Bennett
Counsel for Defendant and Respondent

(Affidavit Of Service Omitted In Printing)

APPENDIX D

Section 84-1503, Revised Code of Montana 1947:

"If the income of any corporation from sources within the state cannot be properly segregated from income without the state, then, in that event, the amount of the net income returned shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the state of Montana bears to the total gross business of the taxpayer, and apportionment shall be made under the rules and regulations prescribed by the state board of equalization, giving consideration to sales, property and payroll and such other factors as may be deemed applicable; provided, however, that the state board of equalization shall, upon the presentation of satisfactory evidence, determine that the income from sources within the state of Montana may be properly segregated from income from sources without the state of Montana and shall allow separate accounting. The board shall publish not less than once a year, all rules and regulations pertaining to this section. All decisions by the board under this section shall be subject to judicial review in an action prosecuted by the corporation in the district court of Lewis and Clark county. The taxpayer cannot change from one method of accounting to another method of accounting without first obtaining permission from the board."

Amended Regulation (Chapter 10) Adopted December 30, 1966. Effective With Respect to Taxable Years Beginning on or After January 1, 1967.

1001. General. When the income of a corporation subject to this tax is derived from or attributable to sources both within and without Montana, the tax is measured by the total net income derived from or attributable to

sources within Montana, and the corporation shall allocate and apportion its income as provided in this chapter of these regulations. It is the intent of regulations 1002 through 1019 to adopt the principles embodied in the "Uniform Division of Income for Tax Purposes Act", and they shall be so construed.

A corporation engaged in a "unitary" business operation within and without Montana must apportion its business income as provided for under section 1010. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses.

A corporation not engaged in a unitary business operation must allocate its business income by means of separate accounting methods as provided for under section 1020; provided, its books and records are so kept that the income and expense attributable to business operations within the state can be properly segregated from total income and expense. If the corporation's books and records do not permit such proper segregation, its business income must be apportioned according to the provisions of section 1010.

1002. Definitions. As used in this chapter of these regulations, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Non-business income" means all income other than business income.

(e) "Sales" means all gross receipts of the taxpayer not allocated under sections 1005 through 1009 of these regulations.

(f) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

1003. Any corporation having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this chapter of these regulations.

1004. For purposes of allocation and apportionment of income under this chapter of these regulations, a corporation is taxable in another state if (1) in that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject the corporation to a net income tax regardless of whether, in fact, the state does or does not.

1005. Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in section 1006 through 1009 of this chapter of these regulations.

1006. (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state:

(1) if and to the extent that the property is utilized in this state, or

(2) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

1007.

(a) Capital gains and losses from sales or other dispositions of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales or other dispositions of tangible personal property are allocable to this state if:

(1) the property had a situs in this state at the time of the sale or other disposition, or

(2) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales or other dispositions of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

1008. Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

1009.

(a) Patent and copyright royalties are allocable to this state:

(1) if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

1010. All business income shall be apportioned to this state by multiplying the income by a fraction, the numer-

ator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

1011. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state in the production of business income during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in the production of business income during the tax period.

1012. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals.

1013. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the State Board of Equalization may require to reflect properly the average value of the taxpayer's property.

1014. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation related to business income, and the denominator of which is the total compensation related to business income paid everywhere during the tax period.

1015. Compensation is paid in this state if;

(a) the individual's service is performed entirely within the state; or

(b) the individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c) some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

1016. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

1017. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government, or (2) the taxpayer is not taxable in the state of the purchaser.

1018. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state; or

(b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

1019. If the allocation and apportionment provisions of sections 1002 through 1018 of this chapter of these regulations do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the State Board of Equalization may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting, if permitted within the scope of section 1001 of this chapter of these regulations;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

1020. Use of Separate Accounting Method. In applying the separate accounting method, each item of income is segregated and directly allocated according to its source. Any expense or other deductible items, including a reasonable allowance for general overhead expenses, attributable to the earning of such income are likewise segregated and deducted from such income. Items of nonbusiness income are to be allocated as provided for under sections 1005 through 1009 of this chapter of these regulations.

APPENDIX E

13249
No. 37750

IN THE
SUPREME COURT
OF THE
STATE OF MONTANA

MONTANA DEPARTMENT OF REVENUE, STATE OF MONTANA,
Petitioner-Appellant,

v.

THE AMERICAN SMELTING AND REFINING COMPANY,
Defendant-Respondent

Appellant's Brief

Appellant's Brief on Appeal from the District Court of the First Judicial District of the State of Montana, in and for the County of Lewis and Clark.

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Attorneys for Defendant-Respondent

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4. *Tax consequences of Department's action.*

Each action of the Department: (1) Adding back into apportionable income, dividends, interest, royalties, rents and gains from the sale of properties: and (2) Combining the net income of ASARCO and its six unitary subsidiaries without regard to such add backs may be considered separately. The following figures show:

1. Income from Montana sources as reported by ASARCO.

2. Income from Montana sources arrived at by adding back business income into apportionable income.

3. Income from Montana sources apportioning the combined net income of ASARCO and its six unitary subsidiaries.

4. Income from Montana sources by apportioning the total combined net income of the unitary corporations, including the added back business income. As to the following figures demonstrate, for two of the four years combination by itself is a tax gain to the taxpayer and tax loss to Montana. The bulk of the tax effect of the Department's [12] action is in adding back into apportionable income that income determined by the Department to be business income and apportionable under its 1967 regulations. Figures for each of the years are as follows:

1967

1. Reported income.	$ 277,832
2. Adding back business income.	1,029,035
3. Combined reporting only.	265,563
4. Adding back business income and combining.	972,092

1968

1. Reported income.	6,981
2. Adding back business income.	1,176,823
3. Combined reporting only.	120,093
4. Adding back business income and combining.	1,125,987

1969

1. Reported income.	306,064
2. Adding back business income.	1,885,233
3. Combined reporting only.	346,702
4. Adding back business income and combining.	1,827,489

1970

1. Reported income.	(2,421)
2. Adding back business income.	2,381,685
3. Combined reporting only.	(125,322)
4. Adding back business income and combining.	2,280,491

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[48]

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Section 84-1509 R.C.M., 1947 provides for consolidation of corporations and not the combined method of reporting.

The lower court's rejection of combination is in part on the grounds that Section 84-1509 is the controlling statute. The court stated that the legislature had addressed itself to the problem "of the combining or consolidating of income of affiliated corporations, and this section being the only section in the Montana corporation license tax which

deals with affiliated corporations, it is controlling." (Opinion, p. 15). Section 84-1509 R.C.M., 1947 deals solely with the determination of the tax liability of the number of corporations which are affiliated, *where all of the corporations have a tax liability to the State of Montana.* Otherwise, there could be no statutory authority for the provision in that statute to apportion the liability to the respective affiliated corporations. If Montana had no jurisdiction, how could the liability be enforced? In the instant case what is being used is an *accounting method* to determine the tax liability of the single corporation, ASARCO. Since the six corporations being combined with ASARCO are not subject to the jurisdiction of Montana, in no way could Montana constitutionally *consolidate* [49] ASARCO with its wholly-owned subsidiaries under Section 84-1509 R.C.M., 1947. This, the district court did not understand. In a consolidation, a portion of the income of each corporation in the group of corporations is being taxed. In the combination, only that part of the entire net income of the group which is attributable to the ONE corporation over which the state has jurisdiction, is taxed. In a consolidation, the property, payroll and sales located in Montana of each member of the group are in the numerators of the apportionment factors. In combination, the numerators are from only one corporation. The apportionment factors in each case include in the denominators the entire property, the entire payroll, and the entire sales of the combined group.

Suppose that Montana wished to consolidate the net income of Union Pacific Railroad Company, a holding company, and its three subsidiaries, one a railroad operation, one an oil exploration, and one a real estate operation. If Montana had jurisdiction to tax all three corporations, it could consolidate the net income of all four corporations. It would then be determining the *combined* income of the *consolidated* group.

In the instant case we are determining the income of ASARCO, a single corporation, by apportioning the combined income of it and related corporations. There is no tax jurisdiction over the affiliates.

• • •

APPENDIX F

BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF THE PROTEST OF AMERICAN SMELTING & REFINING COMPANY, a New Jersey corporation.

Protest of Proposed Deficiency Assessments—Montana Corporation License Tax—Taxable Years 1967, 1968, 1969 and 1970

Comes now AMERICAN SMELTING & REFINING COMPANY, a New Jersey corporation, and for its protest of proposed deficiency assessments of Montana Corporation License Tax for the taxable years 1967, 1968, 1969, and 1970, states as follows:

1. That your Protestant, American Smelting & Refining Company, hereinafter referred to as "Taxpayer", is a corporation organized under the laws of the State of New Jersey with its principal place of business located at 120 Broadway, New York, New York, and that it is engaged in the business of mining, smelting, refining, manufacturing, buying and selling non-ferrous metals, metaliferous and other mineral products. That Taxpayer is engaged in the business in the State of Montana of operating a lead smelter in East Helena, Lewis and Clark County, and holding currently idle minerals lands.

2. That as a corporation organized and existing under the laws of another state and having its principal place of business and corporate domicile outside of the State of Montana, Taxpayer has, for many years last past, including the taxable years 1967, 1968, 1969, and 1970, reported its total net income from all sources within the State of Montana and paid a percentage license fee thereon, all as required by law.

3. That Taxpayer has, as aforesaid, filed the necessary returns for corporation license tax purposes showing its total net income received from sources within the State of Montana and has fully paid the tax thereon including all tax due with respect to the years 1967, 1968, 1969, and 1970. That, notwithstanding the foregoing, the Corporation Tax Bureau of the Department of Revenue of the State of Montana has proposed deficiency assessments for the years 1967, 1968, 1969 and 1970 as more particularly set forth in the letter (with attached schedules) of R. L. Kerns, Auditor, Corporation Tax Bureau, dated March 5, 1973, the same being hereunto attached as Exhibit "A" and by this reference made a part of this Protest.

4. That as to Taxpayer, pursuant to Section 84-1503, RCM, the Department of Revenue (and previously the State Board of Equalization) has determined the income accruing from sources within the State of Montana pursuant to a formula and factors adopted by rules and regulations prescribed by said state agency, and this Taxpayer has properly reported all such income and paid the corporation license tax thereon in accordance with such rules and regulations, formulae and factors for all years through and including 1967, 1968, 1969 and 1970. That the proposed deficiency assessments as contained in Exhibit "A" hereto constitutes an illegal and unlawful departure from the rules and regulations prescribed by the State Board of Equalization (now the Department of Revenue) pursuant to said Section 84-1503, RCM, and constitutes an illegal and unlawful attempt to impose corporation license tax upon income having no relationship to the Montana activities or the value of the privilege of doing business in Montana of and by this Taxpayer and has no reasonable relationship to corporate activities within the State of Montana conducted by Taxpayer; and constitutes an illegal and unlawful attempt to impose a corporation license tax upon income from interest, dividends, royalties, rentals and the sale of capital assets not arising from transactions or ac-

tivities in the regular course of Taxpayer's trade or business or the corporate activities of Taxpayer within the State of Montana.

5. That Taxpayer is informed and on such information states that the proposed deficiency assessments as contained in Exhibit "A" hereto are based upon audits, studies, formulae and factors adopted by the Multistate Tax Commission, which said Multistate Tax Compact is void and illegal by reason of conflict with Article I, Section 10, Clause 3 of the Constitution of the United States, which provides in pertinent part that "No state shall, without the consent of Congress, . . . enter into any agreement or compact with another state or with a foreign power . . ."; and the Congress of the United States has never consented to a Multistate Tax Compact. In addition, said attempted and purported assessments of deficiency (Exhibit "A" hereto) are illegal, as attempted to be applied to this Tapayer, for the reason that pursuant to Article III of the Multistate Tax Compact, as adopted in the State of Montana by Section 84-6701, by Paragraph 1 of said Article III, it is provided that the taxpayer may elect to apportion and allocate income in the manner provided by the laws of the State of Montana or may elect to apportion and allocate in accordance with Article IV of said Multistate Tax Compact. That your Taxpayer has never elected to apportion and allocate income in accordance with Article IV of said Multistate Tax Compact but, to the contrary, has elected to apportion and allocate income in the manner provided by the Corporation License Tax Act of the State of Montana, being Sections 84-1501, et seq, RCM.

6. That after receipt of the deficiency assesments as contained in Exhibit "A" hereto, the Taxpayer, acting by and through its duly authorized attorneys, requested a copy of the audits conducted by the Multistate Tax Commission upon which said deficiency assessments were based, and

said attorneys were informed of the existence of said audits by Mr. R. L. Kerns, Auditor, Corporation Tax Bureau, and Mr. Gerald L. Foster, Chief Auditor, Corporation Tax Bureau, and further informed that copies of said audits would not be furnished to Taxpayer's said attorneys. That by reason of the refusal of the Corporation Tax Bureau of the Department of Revenue to furnish said audits so made by the Multistate Tax Commission, this Taxpayer cannot fully ascertain the manner in which said deficiency assessments (Exhibit "A" hereto) were prepared and cannot fully ascertain what items of income, deduction, apportionment or otherwise were used in arriving at said deficiency assessments.

7. That the Corporation Tax Bureau of the Department of Revenue, in authorizing the auditors of the Multistate Tax Commission to act as agents of the State of Montana, has unlawfully and illegally delegated to unauthorized persons the right to make tax examinations and audits on behalf of the State of Montana; and, further, in attempting to assert the deficiency assessments, Exhibit "A" hereto, has acted illegally and in excess of the authority granted by the Corporation License Tax Act of the State of Montana; has attempted to act under the purported authority of the Multistate Tax Compact (Section 84-6701, RCM) even though Congress has not authorized said Compact; and has attempted to force upon Taxpayer an election to appropriate and allocate income in accordance with Article IV of the Multistate Tax Compact even though Taxpayer has made no such election.

8. That, asserting against this Taxpayer said deficiency assessments (Exhibit "A" hereto) constitutes, as to this Taxpayer, a denial of due process of law and of equal protection of law in that this Taxpayer cannot ascertain from the deficiency assessments so made (Exhibit "A" hereto) upon what factors, items of income, apportionment and other matters the deficiency assessments are proposed;

and that by the refusal of the Corporation Tax Bureau of the Department of Revenue to furnish Taxpayer with a copy of said audits this Taxpayer cannot properly prepare its Protest and is thereby further denied due process of law and equal protection of law.

9. That Taxpayer is informed and believes that by said deficiency assessments (Exhibit "A" hereto) the State of Montana is attempting, contrary to law, to classify the Taxpayer and six other corporations, as one unitary business for Montana Corporation License Tax purposes contrary to Section 84-1509, RCM.

10. That Taxpayer is informed and therefore states that by said deficiency assessments (Exhibit "A" hereto) the State of Montana illegally and unlawfully attempts to allocate rents, royalties from real or tangible personal property, capital gains, interest, dividends, patent or copywright royalties and other income to the State of Montana although the same does not constitute business income, did not arise from transactions and activity in the regular course of Taxpayer's trade or business, and bears no reasonable relationship to the corporate activities of Taxpayer within the State of Montana or to the privilege of doing business within the State of Montana which is the subject of taxation under the Corporation License Tax Act of the State of Montana.

11. That Taxpayer is informed and therefore states that by said deficiency assessments (Exhibit "A" hereto) the State of Montana has purported to apply the provisions of Section 482, Internal Revenue Code, as to allocation of income and deduction to the Taxpayer and certain corporations, all without authority of law.

12. That Taxpayer is informed and therefore states that by said deficiency assessments (Exhibit "A" hereto) the State of Montana has illegally and unlawfully attempted to apply Section 78 of the Internal Revenue Code with respect to dividends received by Taxpayer or other corporations and to thereby include in gross income not only the actual dividends so received but also the foreign taxes deemed to have been paid by virtue of having received such dividends commonly known as "Gross-up of Dividends".

13. That Taxpayer is informed and therefore states that by such deficiency assessments (Exhibit "A") there has been an attempt to allocate to Montana, by some formula, income or claimed income which should not properly be so allocated and that there is no relationship between the property, payroll and sales of the Taxpayer and the income or claimed income attempted to be allocated to the State of Montana; and that not only has there been an attempt to allocate unitary income, but also income of a dual or multiform nature and upon a basis which does not recognize the actual activities in furtherance of the business of the Taxpayer.

14. That the illegal and unlawful attempt by the Corporation Tax Bureau to apportion to the State of Montana income as aforesaid constitutes an illegal and unlawful burden upon interstate commerce.

WHEREFORE, having protested said deficiency assessments (Exhibit "A" hereto), your Taxpayer prays that the Department of Revenue set aside all of such deficiencies and interest thereon and find and determine that the Taxpayer has properly reported for all of said years its income from sources within the State of Montana and properly paid a tax thereon and that said purported and pretended deficiencies are null and void,

OR, IN THE ALTERNATIVE, that the Department of Revenue: (a) order the Corporation Tax Bureau to furnish the Taxpayer with all copies of all audits and other information upon which said deficiency assessments (Exhibit "A" hereto) were made, including, without limitation, all audits and other information furnished by the Multistate

Tax Commission, and (b) that thereafter the Department of Revenue hold a hearing upon this Protest and that at such time the Taxpayer be allowed an opportunity to present additional evidence relating tc its tax liability.

Respectfully submitted this 4th day of April, 1973.

AMERICAN SMELTING & REFINING COMPANY,
a New Jersey corporation

Alexander J. Gillespie, Jr.
Vice President and General Counsel
120 Broadway
New York, New York 10005

Hughes, Bennett & Cain

/s/ By GEORGE T. BENNETT
George T. Bennett
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Attorneys for Taxpayer

RECEIVED and FILED this 4th day of April, 1973.

DEPARTMENT OF REVENUE OF THE
STATE OF MONTANA

By Board of Equal
Its Vernon Miller, Secretary

APPENDIX G

IN THE SUPREME COURT OF THE STATE OF MONTANA

• • • • • •

CAUSE NO. 13249

• • • • • •

MONTANA DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA,
Petitioner and Appellant,

-VS-

THE AMERICAN SMELTING AND REFINING COMPANY,
Defendant and Respondent.

• • • • • •

Respondent's Petition for Rehearing With Argument and Authorities Integrated Therein

Comes now the Defendant and Respondent, THE AMERICAN SMELTING AND REFINING COMPANY (ASARCO), and respectfully petitions the Supreme Court of the State of Montana for rehearing pursuant to Rule 34 of the Rules of Appellate Civil Procedure on the grounds and for the reasons that the decision of this Court made and entered on the 11th day of July, 1977 should be reversed, altered, amended or revised, because facts material to the decision and questions decisive of the case submitted by counsel were overlooked by the Court and that the decision is in conflict with express statutes and controlling decisions to which the attention of the Court was not directed.

[Material on pp. 2-19 of original document omitted.]

MATTER SHOULD BE REMANDED FOR CONSIDERATION OF SUBSTANTIAL CONSTITUTIONAL QUESTIONS RAISED BY PLEADINGS AND OVERLOOKED BY THE COURT

In its Protest to the Department of Revenue, ASARCO alleged that imposition of the asserted tax deficiency would

be contrary to the Commerce Clause and Due Process Clause of the Federal Constitution. (See Protest, pp. 2, 3, 4, 5 and 6). Because STAB and the District Court held that the proposed assessment was not proper as a matter of Montana statutory law, they never reached the Federal Constitutional issues in this case. Accordingly, even if this Court decides that the matters discussed above do not warrant reconsideration, the case should still be remanded to permit full development of the facts and legal arguments bearing on the important constitutional issues raised by the Protest.

In particular, the case should be remanded for the following reasons:

1. *Status of the Multistate Tax Compact:* The audit giving rise to the proposed tax adjustment in this case was conducted by auditors of the Multistate Tax Commission, purporting to act under the authority of the Multistate Tax Compact. (See STAB Findings, Paragraph 6; District Court Findings, Paragraph 6; Petitioner-Appellant's Brief, p.3). The validity of the Multistate Tax Compact under the Federal Constitution is now at issue in *U.S. Steel Corp.* v. *Multistate Tax Commission* (U.S. Sup.Ct. Dkt. No. 76-635, October Term, 1976) which is awaiting oral argument in the United States Supreme Court. This is a class action by U.S. Steel on behalf of all corporations similarly situated which would include ASARCO. The Montana taxing authorities were expressly made a party (J. Morley Cooper, as Chairman of the State Board of Equalization). For this Court's convenience, a copy of the appellant's brief on the merits in the *U.S. Steel* case is attached as Exhibit "B" to this petition. If the U.S. Supreme Court holds that the Multistate Tax Compact is unconstitutional, grave questions will arise as to the validity of the audit conducted in this case by the Multistate Tax Commission. Accordingly, final judgment should not be entered in the present case until STAB and the court below have had an opportunity to consider the impact of the U.S. Supreme Court's decision in the pending *U.S. Steel* case.

2. *Taxation of Passive Income from Property Outside Montana.* Grave constitutional questions are raised by this Court's decision that Montana has jurisdiction to tax dividends, royalties, rents, interest, and gains on stock sales realized by ASARCO from transactions occurring *wholly* outside the State. The U.S. Supreme Court has held that the interstate operations of a foreign corporation may be subjected to state taxation only if "the levy is not discriminatory and is properly apportioned to *local activities* within the taxing state forming sufficient nexus to support the same". *Northwestern Cement Co. v. Minnesota,* 358 US 450, 452 (1959) (emphasis added). It is clear that "the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere". *Connecticut General Life Insurance Co. v. Johnson,* 303 US 77, 80-81 (1938). "When, as in this case, there are different taxing jurisdictions, . . . and the question is necessarily one of apportionment, evidence may always be received to show that a state has applied a method, which, albeit fair on its face, operates so as to reach profits *which are in no just sense attributable to transactions within its jurisdiction." Hans Rees' Sons v. North Carolina ex rel. Maxwell,* 283 U.S. 123, 134 (1931) (emphasis added).

Applying these principles, at least two State Supreme Courts have held that dividend income received by a corporation in one state from subsidiaries operating entirely in other states or foreign jurisdictions may not constitutionally be included in the corporation's apportionable net income for purposes of computing its income tax liability in the former state. *Gulf Oil Corp. v. Clayton,* 147 SE2 522 (Sup.Ct. N.C. 1966); *Square D Company v. Kentucky Board of Tax Appeals,* 415 SW2 594 (Ct. of App. Ky. 1967). Similar considerations led Judge (later Mr. Justice)

Cardozo to hold that the Federal Constitution precluded New York from taxing a corporation doing business in that state on any part of the interest income it earned on bonds held outside the state. *People ex rel. Alpha Portland Cement Co. v. Knapp*, 129 NE 202 (Ct. of App. N.Y. 1920).

At page 24 of the Department's Brief, it is stated:

> "Montana *could not constitutionally* tax ASARCO if ASARCO did not have income from sources within the state." (Emphasis supplied.)

Also at pages 48 and 49 of the Department's brief appears the following:

> "Since the six corporations being combined with ASARCO are not subject to the jurisdiction of Montana, *in no way could Montana constitutionally* consolidate ASARCO with its wholly-owned subsidiaries under Section 84-1509 R.C.M., 1947." (Emphasis supplied.)

This Court, at page 13 of its opinion, states that the case of *Coca Cola Company v. Department of Revenue*, 271 OR 517, 533 P2 788, is "*on all fours* with the instant case". This clearly indicates the Court's misunderstanding of this issue. In the *Coca Cola* case, both the parent corporation and its subsidiary *were doing business* in Oregon, were subject to Oregon's jurisdiction, were deriving income from Oregon sources, and, accordingly, *both had filed returns* with Oregon (pp. 789 and 790 Pac.Rpts.). This is far different from the situation with ASARCO where the Department admits that none of the affiliated corporations are subject to the jurisdiction of the State of Montana and that "in no way could Montana constitutionally *consolidate* ASARCO with its wholly-owned subsidiaries . . .".

How can this Court square its statement that:

> "DOR clearly has the authority to adopt rules and regulations as to apportionment of corporate income *without regard to source*." (Page 7.)

with the Department's admission that to do so would be unconstitutional (P. 24 of Appellant's brief)?

While the U.S. Supreme Court has not yet passed on the constitutionality of applying state income tax apportionment statutes to passive income realized from out-of-state property, the foregoing state decisions make it clear that any attempt by a state to reach such income poses serious constitutional questions, at the very least. As stated in a recent leading article, which the Department cited with approval in connection with another point in its brief in this Court (p. 39):

> ". . . the specific allocation of investment income is at least logically consistent with the proposition that a state should only tax income from in-state sources. Certainly, it would not square with the underlying rational of the Supreme Court cases to subject such income to formulary apportionment." *

Since STAB and the District Court found it unnecessary to reach this issue in their original consideration of the case, the case should be remanded and the record should be reopened to determine whether, on the facts of this case, the Montana statute as interpreted by this Court will result in "extra-territorial values being taxed". See *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942).

3. *Inclusion of Subsidiaries in the Tax Base.* As interpreted by this Court, the Montana statute means that the "net income and apportionment factors of six of

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* Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups", 25 Tax Law Rev. 171, 185 (1970).

ASARCO's wholly owned subsidiaries must be included in ASARCO's computation of apportionable income," even though the six subsidiaries "are clearly separate and distinct from ASARCO". (Slip Opinion, p. 11). Since the record establishes that none of the six subsidiaries has assets or business activities of *any* kind in Montana, inclusion of the subsidiaries' net income in the Montana tax base is obviously subject to serious challenge on constitutional grounds. See e.g., *Interstate Finance Co. v. Wisconsin Department of Taxation,* 137 NW2 28 (Sup. Ct. Wis. 1965); *People ex rel. Alpha Portland Cement Co. v. Knapp, supra.* See also, State Taxation of Interstate Commerce, H. Rep. No. 1480, 88th Cong., 2d Sess. 245 (1964).

Those who seek to defend the constitutionality of the result reached by this Court in the present case generally do so by asserting that the state is not taxing the income of the out-of-state subsidiaries, but is merely using that income to measure the amount of tax properly payable by the local corporation on its income. See, e.g., Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices", 42 Journal of Taxation 106, 108 (1975). However, "[w]hen passing on the constitutionality of a state taxing scheme, it is firmly established that . . . [the U.S. Supreme Court] concerns itself with the *practical operation* of the tax, that is, substance rather than form". *American Oil Co. v. Neill,* 380 U.S. 451, 455 (1965) (emphasis added). Regardless of how the taxing structure approved by this Court is described *verbally,* it can have the *practical effect* of imposing tax on the out-of-state income of separate companies having *no* contact of *any* kind with Montana. Because STAB and the District Court concluded that the Montana statute did not permit a combined calculation, they did not have to reach the constitutional question. The case should therefore be remanded for a finding as to whether or not the "practical operation" of the

statute, as interpreted by this Court, is to impose a constitutionally impermissible tax on the income of out-of-state corporations which are admittedly not subject to Montana's taxing jurisdiction in their own right.

[Material on pp. 26-27 of original document omitted.]

Respectfully submitted this 1st day of August, 1977.

HUGHES, BENNETT & CAIN
STUART L. KELLNER
JOHN F. SULLIVAN

By /s/ GEORGE T. BENNETT
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APPENDIX H

IN THE SUPREME COURT OF THE STATE OF MONTANA

Cause No. 13249

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Petitioner & Appellant,*

-VS-

THE AMERICAN SMELTING AND REFINING COMPANY, *Defendant & Respondent.*

Appellant's Objections To Respondent's Petition for Rehearing

• • • •

COMES NOW the Petitioner and Appellant, THE MONTANA DEPARTMENT OF REVENUE (Department) and objects to AMERICAN SMELTING AND REFINING COMPANY'S (ASARCO) Petition for rehearing filed herein on August 1, 1977. For convenience of the Court, the Department has followed point by point the Petition of the Respondent, and has also integrated as to each point raised, its argument and authorities.

Petitions for rehearing are governed by Rule 34, Rules of Appellant Civil Procedure, and the grounds upon which rehearing petitions are granted are extremely limited.

> "A petition for rehearing may be presented upon the following grounds and *none other*: That some fact, material to the decision, or some question decisive of the case submitted by counsel, was overlooked by the Court or that the decision is in conflict with an express statute or controlling decision to which the attention of the Court was not directed."

It is on those grounds and none other upon which this Court could order a rehearing in this matter. It is submitted by the Department, that this matter was thoroughly

briefed by all parties, that the Court did not overlook any facts or questions submitted by counsel, and that the case is not in conflict with any statute or controlling decision.

[Material on pp. 2-12 of original document omitted.]

ISSUE VIII

MATTER SHOULD NOT BE REMANDED FOR CONSIDERATION OF SUBSTANTIAL CONSTITUTIONAL QUESTIONS RAISED BY PLEADINGS AND OVERLOOKED BY THE COURT.

To begin with, the Department objects to the taxpayer now requesting that additional issues should be decided in this case which were not raised at the original hearing before this Court. Attached as exhibit C to this objection is the taxpayer's proposed Findings, Conclusions and Order submitted to the Department of Revenue at the initial hearing on this matter. The taxpayer did not include any provision in its findings or conclusions as to the constitutionality of the acts of the Department of Revenue.

Also attached as Exhibit D are the Findings of Fact and Conclusions of Law and Order entered by the State Tax Appeal Board, which were verbatim the proposed Findings of Facts and Conclusions of Law submitted by the taxpayer, and they again do not refer to any unconstitutional aspect of the case.

Finally, in the Findings of Fact, Conclusions of Law and Order of the District Court, proposed by the taxpayer, attached as Exhibit E which were adopted verbatim by the Court, no where did the taxpayer raise the constitutional questions it now seeks to interpose. The taxpayer was not precluded at any stage from the hearing before the Department of Revenue to the hearing in the District Court, from raising the constitutional questions. The taxpayer did not raise those issues at any stage in the proceedings, and clearly did not raise those issues before this Court. This Court has repeatedly stated that it will not on

a motion for rehearing consider questions not originally raised in the action. *Mares vs Mares et al,* 60 M.36, 199P. 267.

> "However, this is the first time that this point has been presented, urged or argued, and it is the settled rule that this Court will not, on an application for rehearing, consider grounds for reversal not presented upon the original hearing." P. 55

It is the position of the Department, that even if these matters had been raised previously, which we contend they were not, they were clearly not raised in the original hearing in this Court on this matter and cannot now be raised by the taxpayer.

Sub-Section 1
Status of the Multi-State Tax Compact

The taxpayer asserts that because the audit was performed by the Multi-State Tax Commission, and the validity of the compact is at issue in the United States Supreme Court, that it effects the decision in some way. In opposition, we cite to the Court the brief of the taxpayer filed in opposition to the motion of the Multi-State Tax Commission to participate in this matter as amicus curiae, dated May 12, 1976. In that brief, the taxpayer takes a somewhat different position.

> "It is true that the audit which formed this basis of this litigation was conducted by the Multi-State Tax Commission. *But this act has no bearing whatsoever on the issue on appeal herein.* There never was any question in this case as to the audit information. Thus, the issue on appeal does not relate to the validity of the mechanics of the audit. Rather, the issue on the Department's appeal concerns the time at which the principals of UDITPA became effective in Montana. This issue, ASARCO submits, is solely and exclusively

> one of Montana law, in which the Multi-State Tax Commission has not one bit of interest with respect to which there is no need whatsoever to 'uniform interpretation and application by the member states' of the Multi-State Tax Commission." (Emphasis supplied)

The Department could not have have rebutted the argument any better than the taxpayer has.

Sub-Section 2

Taxation of Passive Income from Property Outside Montana

The Respondent begins this argument with the following statement:

> "Grave constitutional questions *are raised* by this Court's decision that Montana has jurisdiction to tax dividends, royalties, rents, interest and gains on stock sales realized by ASARCO from transactions occurring wholly outside the state." p. 21.

These grave constitutional questions have never been presented to this Court prior to this petition for hearing. If this had been a consideration of the taxpayer, these cases could have been briefed and argued prior to this late date. As the *Mares* case *supra* indicates, it is not proper in a petition for rehearing to raise new issues.

On page 23 of the Respondent's petition, beginning at line 13, it is again clear the taxpayer's misunderstanding of the issue of combination. The Court was quite correct in ruling that the case of *Coca-Cola Co. vs. Department of Revenue,* 271 OR 517, 533 P.2d 788, is on all fours with the instant case. The question there involved the unitary operation of Coca-Cola and its subsidiaries. The situation is exactly the same with the taxpayer and the subsidiaries

which were combined, because they were conducting a unitary operation.

Finally, it is incorrect for the taxpayer to indicate that STAB and the District Court found it unnecessary to reach these new constitutional issues, because the fact simply is, that the issues were in fact never presented to those tribunals for their decision. More importantly, they were not presented to this Court by the taxpayer, prior to this time.

Sub-Section 3
Inclusion of Subsidiaries in the Tax Base

Sub-Section 3 is a rehash of sub-section 2 of this issue. The taxpayer has not cited any case whereby the acts of the Department as upheld by this Court are unconstitutional. Rather the taxpayer is asking this Court to give them another opportunity to reargue their case on different grounds. The Department contends that these issues were not raised before STAB or the District Court and therefore the case cannot now be remanded for a determination of these new issues.

[Material on pp. 15-16 of original document omitted.]

CONCLUSION

A careful review of the petition, clearly indicates that the taxpayer has not raised any issue which comes within the parameter of Rule 34 Montana Rules of Appellate Procedure. Of the first eight issues, if they were raised they were discussed by the parties in the briefs and by this Court in the opinion, and are laid to rest; if they were not raised, they cannot be argued now. Of the constitutional issues, these were not raised in the prior proceedings; they were clearly not raised in the original hearing before this Court; the taxpayer had every opportunity to argue at the prior stages the constitutional question, and failed to do so. It is improper at this stage of the proceedings to

grant a rehearing to hear issues not previously raised. Finally, the Court's opinion did not overlook any issues raised; the deficiency assessment will not include any amount represented by "gross up"; the question of the gain on the sale of stock of General Cable and Revere Copper was clearly considered by the Court and found to be business income.

THEREFORE, the Department respectfully requests that the petition of the Respondent for rehearing be denied on all grounds.

DATED this 4th day of August, 1977.

Respectfully submitted,

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THEODORE B. DELOOZE

/s/ TERRY B. COSGROVE
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Supreme Court, U. S.
FILED
DEC 28 1977
MICHAEL RODAK, JR., CLERK

In the Supreme Court

of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO Incorporated (formerly The American Smelting and Refining Company) *Appellant*,

vs.

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee*.

Appeal from the Supreme Court of the State of Montana

MOTION TO DISMISS APPEAL

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A. THE CONSTITUTIONAL ISSUES WERE NOT RAISED BEFORE THE PROPER ADMINISTRATIVE AGENCY, WHICH IS THE STATE TAX APPEAL BOARD, NOR WERE THEY RAISED BEFORE THE MONTANA DISTRICT COURT OR THE MONTANA SUPREME COURT BUT WERE ABANDONED AFTER THE HEARING BEFORE APPELLEE. 2

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In the Supreme Court
of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO Incorporated (formerly the American Smelting and Refining Company), *Appellant*,

vs.

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee*.

Appeal from the Supreme Court of the State of Montana

MOTION TO DISMISS APPEAL

Appellant moves the Court to dismiss the appeal herein on the following grounds:

I.

THE APPEAL IS NOT WITHIN THE JURISDICTION OF THE COURT SINCE THE APPELLANT HAS NOT PROPERLY RAISED THE VALIDITY OF ANY STATUTE OF THE STATE OF MONTANA OR OF ANY ADMINISTRATIVE ACT OF APPELLEE AS BEING REPUGNANT TO THE CONSTITUTION OF THE UNITED STATES.

A. THE CONSTITUTIONAL ISSUES WERE NOT RAISED BEFORE THE PROPER ADMINISTRATIVE AGENCY, WHICH IS THE STATE TAX APPEAL BOARD, NOR WERE THEY RAISED BEFORE THE MONTANA DISTRICT COURT OR THE MONTANA SUPREME COURT BUT WERE ABANDONED AFTER THE HEARING BEFORE APPELLEE.

To come within the jurisdiction of this Court under 28 U.S.C. Sec. 1257(2) a party must make explicit and timely insistence in the state court that the state statute as applied, is repugnant to the federal constitution. See *Stalge vs. State of Ohio*, 366 U.S. 259, 81 S.Ct. 1076 (1961), *Rohr Aircraft Corp. vs. County of San Diego*, 362 U.S. 628, 80 S.Ct. 1050 (1960).

A review of the record will indicate such explicit and timely insistence of constitutional questions was not made by the Appellant. At first glance, it appears that in the protest filed by the Appellant with the Appellee in April of 1973 constitutional questions may have been raised; however a careful review of the record indicates that the issues were abandoned after a hearing was held pursuant to Section 84-1508.1 R.C.M. 1947, on the deficiency assessment. This hearing under Montana law, as interpreted by the Montana Supreme Court, was only an opportunity for the taxpayer to request a review of the administrative procedure used to calculate the assessment and to allow the taxpayer to present evidence in support of its tax calculation. See *W. R. Grace and Co. vs. Department of Revenue of the State of Montana*, . . . Mont. . . ., 567 P.2d 913 (1977). After the hearing, the Appellee denied the Appellant's request that the deficiency be vacated; the Appellee then filed an appeal to the State Tax Appeal Board (Board) under the Montana Administrative Procedure Act (Title 82, Chapter 42, R.C.M., 1947). The appeal to the Board is a trial de

novo; it is the record established at the Board which alone constitutes the record for purposes of any further appeal. Any judicial review of the findings by the Board, is limited solely to the record as made before the Board. *W. R. Grace* case, *ibid*, and Section 84-709.1 R.C.M. 1947 and Section 82-4216 R.C.M. 1947.

The record of the proceedings before the Board is devoid of any mention of constitutional matters. In appealing from an adverse decision of the Appellee, it was incumbent upon the Appellant to raise all questions including any question concerning the constitutionality of any statute or action of the Appellee, a copy of the brief of the Appellant and filed with the Board is attached as Appendix A, page 1a. In that brief the Appellant sets forth the issues on appeal, no mention is made of any constitutional questions. The Findings of Fact and Conclusions of Law submitted by the Appellant to the Board which were adopted in toto by the Board again contain no reference to any constitutional issue. See Appellant's Appendix A, page 39a.

At the hearing before the District Court on judicial review, again the Appellant did not raise any questions relating to the constitutionality of any statute or any action taken by the Appellee. Finally, when the matter was on appeal to the Supreme Court of Montana, no mention was made at any time by any party of any constitutional aspect of this proceeding. It was not until the Appellant's Petition for Rehearing that the constitutional issues mentioned in the initial petition were attempted to be reviewed.

Appellant contends that the Board and the State District Court proceeded to rule in Appellant's favor on statutory grounds and it was therefore unnecessary and improper for either the Board or the District Court to

consider the constitutional question. Appellant cites *State ex rel Hammon vs. Hager* 160 Mont. 391, 503 P.2d 52 (1972) in support of its position. However, that case and the others cited by Appellant clearly show the court in those cases refused to decide a constitutional issue actually brought before the court. In this case not only were the constitutional questions not properly raised before the Board but they were abandoned after the hearing before Appellee. (See discussion I (B) below). The simple fact is that neither the Board or the District Court decided the case on constitutional grounds, because none were presented.

Appellant also contends that the Supreme Court of Montana has ruled that a constitutional issue may be raised at any time, even in a petition for rehearing and must be considered by the court whenever raised. In support it cites *In Re Clark's Estate*, 105 Mont. 401, 74 P.2d. 401, (1937). That decision, if not specifically overruled, has been severally limited by more recent decisions of the Montana Supreme Court. The Montana Supreme Court approves the position that constitutional questions cannot be raised for the first time on appeal, quoting 11 AM JUR Constitutional Law as follows:

> "A person whose rights are invaded by an act of the legislature or of an administrative board must raise the objection at the earliest available opportunity and *exhaust the remedies* which may have been provided for the correction of unreasonable and improper orders, before he will be permitted to make an attack in the courts on the constitutionality of the statute." (Emphasis added) *Union Interchange Inc. vs. Allen*, 140 Mont. 227, 370 P.2d. 492, 495 (1962)
>
> *Johnson vs. Doran*, 167 Mont. 501, 540 P.2d 306 (1975).

The cases make it clear, for any issue including constitutional issues to be a proper subject of consideration for the Montana Supreme Court, they must be raised properly *throughout* the proceedings. A Petition for Rehearing is not the proper vehicle to raise for the first time in the Montana Supreme Court a constitutional issue. *Mares vs. Mares*, 60 Mont. 36, 199 Pac. 267 (1921) and Rule 34 Montana Rules Appellate Civil Procedure, (Appellee's Appendix *B*, p. 7a.) See also *Citizens National Bank of Cincinnati vs. Durr*, 257 U.S. 99, 42 S.Ct. 15 (1921).

The Appellant's remedy was to raise at the de novo proceedings before the State Tax Appeals Board and at the District Court and Montana Supreme Court the constitutional issues it now asserts. A matter which consists solely of interpretation of state statutes cannot now be twisted into a constitutional question to gain direct appeal access to the United States Supreme Court under 28 U.S.C. 1257(2).

B. CONSTITUTIONAL ISSUES IF AT ONE TIME RAISED BY THE APPELLANT AT THE HEARING BEFORE THE DEPARTMENT OF REVENUE, WERE SUBSEQUENTLY ABANDONED.

Appellant argues that its constitutional questions were properly raised at the earliest opportunity. The Appellant cites excerpts from its protest filed April 4, 1973 with the Department of Revenue (Appellee), page 64 of the Appendix of the Appellant.

In the protest, the Appellant refers to the status of the Multistate Tax Commission, and complains that Appellee failed to disclose to the Appellant, copies of the audits performed by the Multistate Tax Commission, upon which said assessments were based; therefore Appellant was unable to prepare a defense in this

matter. More specifically, in paragraph 8 of its protest, (Appellant's Appendix F, p. 67a) Appellant asserted that it was denied due process and equal protection by the failure of the Appellee to provide to the Appellant copies of the audits and work papers used by the Multistate Tax Commission which formed the basis of the deficiency assessments.

After listing the constitutional issues, the Appellant's protest then asked for alternative relief. It asked that:

> "WHEREFORE, having protested said deficiency assessments (Exhibit "A" hereto), your taxpayer prays that the Department of Revenue set aside all such deficiencies and interest thereon and find and determine that the taxpayer has properly reported for all of said years its income from sources within the State of Montana and properly paid a tax thereon and that the said purported and pretended deficiencies are null and void, OR, IN THE ALTERNATIVE, that the Department of Revenue: (a) order the Corporation Tax Bureau to furnish to the Taxpayer with all copies of all audits and other information upon which said deficiency assessments (Exhibit "A" hereto) were made, including, without limitation, all audits and other information furnished by the Multistate Tax Commission, and (b) that thereafter the Department of Revenue hold a hearing upon this protest and that at such time the taxpayer be allowed an opportunity to present additional evidence relating to its tax liability." Appellant's Appendix page 69a and 70a.

The alternative relief requested was granted, in that the documents requested by the Appellant including all the copies of the audits, work papers and narrative reports that were prepared by the Multistate Tax Commission auditors were supplied to the Appellant's counsel prior to the hearing before the Department. Some con-

stituted exhibits *F* and *G*, at the original hearing before the Department. (Transcript of hearing before the Department, October 1, 1973, page 2.) Once the documents had been provided, the hearing was held allowing the Appellant to present any additional evidence relating to its tax liability as it requested in the initial protest. Appellant proceeded to give testimony and introduce exhibits.

The relief prayed for by the Appellant in its protest being in the alternative, and the alternative relief having been granted, Appellant received what it requested in its protest before Appellee. Appellant thereafter abandoned its constitutional issues as they were not raised or mentioned again until the petition for rehearing filed with the Montana Supreme Court. The conclusion is inescapable that the constitutional issues were clearly abandoned.

C. THE QUESTIONS RAISED IN THE PETITION BEFORE THE DEPARTMENT OF REVENUE FRAME NO CLEARLY DEFINABLE CONSTITUTIONAL ISSUES.

The protest filed by the Appellant with the Department (Appellant's Appendix F, p. 64a) attempted to raise three constitutional issues but in fact did not raise any clearly definable constitutional question.

In Section 5 of the protest, page 66a of the Appellant's Appendix, reference is made to the fact that the audit was performed by employees of the Multistate Tax Commission and the Multistate Tax Compact may be void. What constitutional infirmity is created is never defined or enumerated. Nowhere is it asserted that the assessment is void as a violation of any constitutional provision. In Section 7 of the protest it is asserted that the corporation tax bureau acted illegally by delegating

to Multistate Tax Commission personnel the audit of appellant. This may be an issue of state law — delegation of Appellee's statutory authority — but this is not an issue of federal constitutionality.

In Section 8 of the protest, page 67a of the Appellant's Appendix, Appellant asserts that it was denied due process and equal protection because it could not ascertain what factors or matters were used in the proposed deficiency as that certain information had not been supplied as requested. That issue was laid to rest even prior to the initial hearing before the Appellee because the information was provided. (See argument I (B).

Finally, in Section 13 and 14 of the protest, an assertion is made that the assessment by the corporation tax bureau constitutes an illegal and unlawful burden on interstate commerce. It is necessary for a party to clearly set out a constitutional issue in a comprehensible manner so that it can be defined and discussed.

> "There are various ways in which the validity of a state statute may be drawn in question on the grounds that it is repugnant to the Constitution of the United States. No particular form of words or phrases is essential, but only that the claim of invalidity and the ground therefor be brought to the attention fo the state court *with fair precision and in due time.*" (Emphasis added) *Street vs. New York*, 394 U.S. 576, 584, 89 S.Ct. 1354 (1969).

The alleged burden on interstate commerce was not asserted with fair precision and in due time. In Section 13 of the protest (Appellant's Appendix, p. 69a) the allegation is made that Appellee attempted to allocate to Montana "by some formula, income or claimed income which should not properly be so allocated"; that there is no relationship between the property, payroll and sales of Appellant and the income attempted to be allocated

to Montana; and that there was an attempt to allocate not only unitary income but also income "of a dual or multiform nature and upon a basis which does not recognize the actual activities in furtherance of the business of the Taxpayer." Section 14 of the protest (Appellant's Appendix, p. 69a) then states that these attempts constitute "an illegal and unlawful burden upon interstate commerce." The wording of Section 13 of the protest makes it clear that the taxpayer did not know exactly upon what basis it could assert its unconstitutional claim; it had already asserted in the protest that it did not have the necessary information and facts as to how the Department had made its assessment. Section 13 and 14 constitute a general, "catch-all" assertion of unconstitutionality which says, in effect, that whatever method the Appellee used was unconstitutional.

As previously stated, Appellee furnished to the Appellant all of the necessary information for an understanding of the assessments. Having said information, having had a hearing and the Department of Revenue's order affirming the assessments, it was then incumbent upon the Appellee to clearly define the grounds upon which it might assert the unconstitutionality of the acts of the Appellee or of the Montana statutes. As already stated in this brief, these constitutional issues were abandoned and never reasserted or spelled out until an attempt was made to spell them out in the petition for rehearing in the Montana Supreme Court. Clearly, the Appellant can not now come forth and point to these vague, "catch-all" assertions of unconstitutionality in its original protest before Appellee as grounds upon which it can assert the unconstitutionality of a state statute as required under 28 U.S.C. 1257(2) for jurisdiction before this court.

D. VALIDITY OF SECTION 84-1503, R.C.M. 1947 HAS NOT BEEN QUESTIONED, THEREFORE APPELLEE HAS NOT ESTABLISHED PROPER GROUNDS FOR APPEAL UNDER 28 U.S.C. 1257(2).

A review of the jurisdictional statement in this matter indicates that what the Appellant is questioning is the validity of the acts taken by the Department of Revenue, and not the constitutionality of any statute. There has been no challenge to the constitutionality of Section 84-1503 R.C.M. 1947, or any statute in the Corporation Tax Act 84-1501 et seq. The question raised by the Appellant is whether or not Montana is taxing property beyond its jurisdiction. The constitutionality of that process can only be reviewed by this Court as a matter of discretion by a writ of certiorari and not as a matter of right under 28 U.S.C. 1257(2). *Anderson vs. Durr*, 257 U.S. 99, 42 S.Ct. 15 (1921), and *Dana vs. Dana*, 250 U.S. 220, 39 S.Ct. 449 (1919).

No particular statute has been challenged as unconstitutional in the Jurisdictional Statement, therefore, the appeal is not properly within 28 U.S.C. 1257(2). Appellant therefore urges that jurisdiction is not properly vested with this court and Appellee's Motion to Dismiss should be granted.

II.

APPELLANT HAS NOT PRESENTED ANY SUBSTANTIAL FEDERAL QUESTIONS WORTHY OF REVIEW BY THIS COURT.

Three questions relating to the proper function of state income tax laws are raised in Appellant's Jurisdictional Statement under the heading "(2) The Federal Questions", at page 10. Notwithstanding the position of Appellee that these issues were not properly raised in the

court below, and therefore are not subject to review at this stage, Appellee will discuss them to further demonstrate that this court should dismiss this appeal as raising no substantial federal questions worthy of review. U.S. Supreme Court Rule 16(2) (b).

A. THE ROLE OF THE MULTISTATE TAX COMMISSION.

This argument propounded by the Appellant is without the basis of any supporting citations. It is the Appellant's position that a serious constitutional issue is raised as to the validity of the Montana tax assessments if this court determines that the Multistate Tax Compact is illegal under the United States Constitution. *United States Steel Corp. vs. Multistate Tax Commission*, Dkt. No. 76-635, prob. juris. noted, 429 U.S. 1088 (1977).

There has never been any question throughout the entire case concerning the accuracy or voluntary nature of any of the audit information. The Appellant framed the issue on appeal as it relates to the Multistate Tax Commission audit in its brief in opposition to the motion of the Multistate Tax Commission to participate as amicus curiae before the Montana Supreme Court, as follows:

> "It is true that the audit which formed the basis of this litigation was conducted by the Multistate Tax Commission. But this fact has no bearing whatsoever on the issue on appeal herein. There never was any question in this case as to the audit information. Thus, the issue on appeal does not relate to the validity of the mechanics of the audit. Rather, the issue on the Department's appeal concerns the time at which the principals of UDITPA became effective in Montana. This issue, ASARCO submits, is solely and exclusively one of Montana law, in which the Multistate Tax Commission has not one

> bit of interest and with respect to which there is no need whatsoever for 'uniform interpretation and application by the member states' of the Multistate Tax Commission." Page 2. (The entire brief is set out in Appellee's Appendix C, p. 8a-17a.)

Although counsel believes this court will rule the Commission to be constitutionally valid, counsel does not see how the decision will affect the issues in this matter.

The status of the Commission does not affect the accuracy of the figures of the audit, the years of the audit, the voluntary nature of the accessibility of the books and records audited, or the Montana statutes in effect during the years in question.

It is true that the audit was conducted primarily by employees of the Commission; however, an auditor from the state of Montana participated in the audit and was a witness at the Department of Revenue hearing on the assessments. The testimony at the hearing made very clear that the audit was reviewed by the Corporation License Tax Division staff of the Department of Revenue; that the Corporation License Tax Division staff decided whether or not to accept the audit; and that the Corporation License Tax Division staff sets the policy which the commission auditors follow. This audit was accepted independently of the Multistate Tax Commission auditors who had no authority beyond the making of the audit. (Transcript of hearing before the Department, October 1, 1973, pages 48 and 49) The audit information was not utilized under any mandate or legal authority of the Commission, but rather the license tax provision of the Montana statute.

It is true that Mr. Theodore W. de Looze is co-counsel in this litigation. However, he was first appointed a special Assistant Attorney General for the State of Montana and did not become involved in this case until after the factual record was made before the State Tax Appeals Board and the matter decided by the Board. Mr. de Looze was associated with the Department counsel throughout the subsequent proceedings. The chief counsel for the Commission, Mr. William D. Dexter, appeared as amicus curiae, but only filed a brief in this matter because of the objection of the Appellant.

What can be the constitutional effect of compact invalidity? In view of the voluntary nature of the auditors access to Appellant's books and records, there can be no Fourth or Fifth Amendment constitutional questions. Appellant alludes merely to vague generalities and cannot point to what specific effect any constitutional invalidity of the commission would have on the case. Appellant has raised only political and personal considerations, i.e., the role of the western states and of certain individuals, which can have no bearing on the case.

B. TAXATION OF "INVESTMENT" INCOME.

It is a well settled concept in the field of state taxation of multistate corporations, that the taxing state is permitted to tax income of the out-of-state corporation as long as it is properly apportioned to the local activities within the taxing state. *Northwestern States Portland Cement Co. vs. Minnesota*, 358 U.S. 450, 79 S.Ct. 341 (1959). With that point, the Appellant and Appellee agree. However, it is the method of making the proper apportionment which was the issue before the Montana courts. Appellant is a unitary business. It itself admitted that, and it was the finding of both the district court and the Montana Supreme Court. Because Appellant is a unitary business, for tax purposes it concluded that it could not separately account for its income as to its

various mills, plants, refineries, smelters and other places of business, but could only account for its total operating income. Appellant itself has admitted that it used the three-factor formula for apportioning its operating income, but did not apportion what it calls "investment" or "passive" income.

Section 84-1503, R.C.M. 1947, regulating the apportionment of net income, requires one of two methods, either separate accounting of the income from sources within the state, or if such income cannot be segregated, apportionment of the total net income of the corporation. Apportionment is to be made according to regulations prescribed by the Appellee, giving consideration to the factors of payroll, property and sales. The Montana Supreme Court found that only these two methods were allowed under the plain and clear language of the statute and specifically rejected the hybrid method selected by the Appellant to apportion operating income and to separately account for so-called "investment income". Since the income of Appellant's unitary business can not be properly segregated by sources, it must be apportioned to the local activities within the state of Montana, and this the Montana Supreme Court approved.

Appellant argues that since the "investment income" could be segregated as to source, that it must be allocated to its source for tax purposes. On the other hand, the Appellee and the Montana Supreme Court found that this income was business income under the Appellee's regulations, and part of the apportionable income from the unitary operation of the taxpayer.

The Montana Supreme Court's opinion, beginning on page 1a of the Appellant's Appendix, went through the "investment income" item by item listing specifically why the income was business income and fully apportionable. Income which is part of the business operations of the taxpayer, is apportionable. See *Cleveland Cliffs Iron Co. vs. Michigan Corp. and Securities Commission*, 351 Mich. 642, 88 NW 2d 654 (1957) (holding investment portfolio part of business income and apportionable); *Flint vs. Stone Tracy Co.*, 220 U.S. 107, 31 S.Ct. 342 (1911); *Great Lakes Pipeline Co. vs. Commissioner of Taxation*, 272 Minn. 403, 138 NW 2d 612 (1965) (holding profits from investments from intangibles became part of apportionable income); *Montgomery Ward Co. Inc. vs. Commissioner of Taxation*, 276 Minn. 479, 151 NW 2d 294 (1967) (value of intangible securities held by corporation held to be apportionable income); *Sperry and Hutchinson vs. Dept. of Revenue*, 270 Or. 329, 527 P.2d. 729 (1974) (company's investment portfolio income includable as apportionable income where used in business).

While the situs of "investment income" can be determined, this court has made it clear that such a test is not determinative of whether the income is taxable by a state. In *Curry vs. McCanless*, 307 U.S. 357, 373, 59 S.Ct. 900 (1939), this court rejected a situs test for the determination of the power to tax under the due process clause, saying:

> "We find it impossible to say that taxation of intangibles can be reduced in every case to the mere mechanical operation of locating at a single place, and there taxing, every legal interest growing out of all of the complex legal relationships which may be entered into between persons . . .
>
> We have recently declined to press to a logical extreme the doctrine that the Fourteenth Amendment may be invoked to compel the taxation of intangibles by only a single state by attributing to them a situs within that state."

A state in which an intangible is used in business does not enjoy exclusive power to tax the intangible; every state that provides any protection to the intangible or its owners enjoys a similar taxing power. The business income test as adopted in Montana in the regulations of the Department for the purpose of determining whether or not the income of a unitary corporation will be apportioned or allocated, is the test embodied in the Uniform Division of Income for Tax Purposes Act. This Uniform Act was adopted by the National Conference of Commissioners on Uniform State Laws in 1957, and is followed by 28 jurisdictions*.

This test includes as "business income", income arising from the transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the property constitutes an integral part of the taxpayer's regular trade or business operations. If the income does not fall within that definition, then it is allocated to commercial domicile or other situs, according to the terms of the Act. It is whether or not the income arose out of the taxpayer's unitary business operation which determines whether the income will be included in the apportionable income of the taxpayer.

It is important to note that the Montana regulations utilized in determining Appellant's assessments were patterned after the Uniform Division of Income for Tax Purposes Act. Regardless of any practices for the appor-

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*Alabama, Alaska, Arkansas, California, District of Columbia, Colorado, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Michigan, Missouri, Montana, Nebraska, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Virginia, and W. Virginia.

Source: Commerce Clearing House, Inc., State Tax Guide, p. 1043.

tionment or allocation of income previously adopted in states utilizing this Uniform Act, the Act specifically provides that the first test to be applied to these categories designed by Appellant as "investment income" is whether the income comes within the definition of "business income". Only if the income falls outside of this test does it then become allocable as "nonbusiness income" under the specific allocation provisions of the Uniform Act. The mere fact that it can be called "passive" or "investment income" does not, by itself, determine whether it is to be allocated to commercial domicile or some other specific source, or whether it is to be apportionable income. This point was specifically considered by the Oregon Supreme Court in the *Sperry and Hutchinson* case, *supra*.

The Appellant has pointed out that the inclusion of this income increases the amount of tax the Appellant has to pay. In support of this argument the Appellant cites *Hans Rees' Sons, Inc. vs. North Carolina ex rel Maxwell*, 283 U.S. 123, 51 S.Ct. 358 (1931). The facts of that case are clearly distinguishable. In that instance the evidence showed that the average income having its source in the state of North Carolina was approximately 17%, while the taxing formula of North Carolina allocated approximately 80% of the company's net income to that state. This court found unreasonable and arbitrary the attribution to North Carolina of a percentage of the income out of proportion to the business transacted by the taxpayer in North Carolina. Such is clearly not the fact here. Appellee has required Appellant to apply to its net business income acquired through its unitary business operations the three-factor formula, to apportion to Montana only its share, according to property, payroll and sales in Montana. There has been

no showing that this method of apportionment is unreasonable or in any extent arbitrary.

Appellant argues that allowing the state of Montana to include this "investment income" as part of the apportionable income, raises the possibility of multiple taxation. This Court has made it clear it cannot deal in abstractions, that the burden is on the taxpayer showing that in fact this formula places a burden on interstate commerce and in fact there has been multiple taxation. There is no evidence anywhere in this record on that point and the argument must be rejected. See *Northwestern States Portland Cement Co. vs. State of Minnesota, supra.*

The test of business income provided under the Uniform Act as adopted by the regulations of the Appellee does not create any extra-territorial taxation on the part of Appellee. It is in use by 28 jurisdictions, and is by far the most important factor in creating uniformity of taxation among the several states.

Rather than viewing the inclusion of this business income in apportionable income as a "gross disparity — representing an eleven-fold increase in Appellant's tax liability" (Appellant's Jurisdictional Statement, p. 14), it may more accurately be viewed as overcoming a gross under-reporting by Appellant of income attributable to Montana sources. Appellant's method of reporting was based on first deducting all expenses of earning both what Appellant calls "operating income" and "investment income", to arrive at a federal taxable net income, and then deducting all so-called "investment income", so as to achieve for two of the tax years (1968 and 1970) a negative apportionable income. (Appendix D, pages 18a — 21a.) Because of such practices, the method provided for in the Uniform Act must be used to

fairly attribute income to sources in the states of operation.

The cases cited by the Appellant, page 16, Appellant's Jurisdictional Statement, are not in point. They hold that if the income is *not* part of the unitary business activities of the corporation, it will not be subject to apportionment by a non-domiciliary state. These cases are consistent with the acts taken by the Appellee, the Montana Supreme Court decision, and the Uniform Act. Here the Appellant is unitary, and the income in question is business income, a part of the unitary operation of Appellant, and therefore apportionable.

This Court has previously approved the use of a three-factor formula, as used in this case. *General Motors vs. District of Columbia*, 380 U.S. 553, 85 S.Ct. 1156 (1965). It has approved formulary apportionment of income, *Underwood Typewriter Co. vs. Chamberlain*, 254 U.S. 133, 41 S.Ct. 45 (1920), *Bass Ratcliff and Gretton vs. State Tax Commission*, 266 U.S. 271, 45 S.Ct. 82 (1924), *Butler Bros. vs. McColgan*, 315 U.S. 501, 62 S.Ct. 701 (1942), *Northwestern States Portland Cement Co. vs. State of Minnesota, supra*, as long as the income apportioned bears some relation to the activities in the state. In this instance we have apportionment of unitary business income by a three-factor formula which is clearly permissible under the cases cited herein.

C. COMBINATION OF APPELLANT'S INCOME WITH THE INCOME OF CERTAIN OUT-OF-STATE SUBSIDIARIES TO ARRIVE AT THE TOTAL APPORTIONABLE NET INCOME OF THE ECONOMIC UNIT.

Appellant, on page 17 of its Jurisdictional Statement, misstates the nature of the combination of the Appellant

and its six unitary subsidiaries. What the Appellee has done, is to determine the income attributable to Montana sources by apportioning the combined income of Appellant with its unitary affiliates. The use of the combined report as to a group of related corporations engaged in a single unitary business operation is an accounting method designed to arrive at the true net income of an economic unit. It is the logical outgrowth of the unitary concept as applied to the single corporation. The Appellant has admitted (see page 10a of Appellee's Appendix, Opinion of the Supreme Court of Montana) that it is a unitary activity with respect to mining, milling, smelting, refining and sales of the company even though most all of these activities are carried on entirely outside of Montana. Appellant could just as well argue that most of these activities have no visible connection with the smelter operation within Montana, and are earning income outside of Montana's jurisdiction. The admission of Appellant that all such activities are unitary also admits the validity of the unitary concept as applied to the far-flung activities within the corporate shell. What the Appellee has done is to review the total corporate business activities of Appellant and the activities of its controlled corporations and found that Appellant's activities with these affiliated corporations are part of the unitary business activity in the same way as the mining, milling, smelting, and refining activities conducted outside of Montana are within the corporate shell of ASARCO and are unitary.

Appellant's basic argument that combination is inappropriate is two-fold: (i) the subsidiaries in question did not have sufficient contact with Montana to be subject to its taxation jurisdiction; and (ii) Appellant's income could be determined without reference to that of its subsidiaries and therefore there was no authority under 84-

1508 for a combined return. In 1962 Appellant requested permission of Montana to report on the unitary method. By reporting under this method, for many years Appellant has been including as apportionable net income the income from operations completely outside of Montana. Because the determination of net income is, in the first instance, an economic and accounting problem, inclusion of all income from all unitary operations, whether by a division within the corporate shell or by a subsidiary, whether located in or outside Montana's jurisdiction is not only logical, but necessary to determine accurately the total net income to be apportioned to Montana.

The power to require a combined return does not rest with the provisions of Section 84-1508, R.C.M. 1947, nor does it rest with the determination of whether or not the Appellee has any jurisdiction over the related corporations. It comes from the authority of the Appellee to properly determine the income of the taxpayer attributable to the state, Section 84-1503, R.C.M., 1947.

A combined return was first utilized in the State of California over 30 years ago and approved in the case of *Edison California Stores vs. McColgan*, 183 P.2d. 16 (1947).

There was no specific statutory authority in California for combined returns. The California Supreme Court found that the combined return was proper under the statutes:

> "Power to apply the formula apportionment in this or in the Butler Brothers case is not derived from the authority to require the filing of consolidated returns, since the latter indicates that the income of the group will be taxed as a unit. The power flows from the authorized method of ascertaining the

income attributable to a taxpayer's activities within the state; . . .

"The ascertainment of income by the apportionment method is not necessarily a disregard of the corporate entity nor extension of the provisions of the statute by implication. Formula allocation is merely a method of ascertaining the true income attributable to the Plaintiff's business and the method is authorized by statute." *Edison California Stores, supra*, at pp. 21-22.

Oregon has also required the filing of a combined return. See *Zale-Salem, Inc. vs. Tax Commission*, 237 Or. 261, 391 P.2d. 601 (1964), *Coca Cola Co. vs. Department of Revenue*, 271 Or. 517, 533 P.2d. 788 (1975).

To the extent this method of reporting produces an increase in Montana's share of taxable income, it is clearly not based on any assertion of jurisdiction over Appellant's subsidiaries but is based solely on the fact that the Appellant's total net income is derived from conducting unitary activities through the use of separate divisions of the same corporation, and separate wholly owned corporations. The same criteria are utilized in determining if a group of corporations are unitary as in the case of a single corporation with separate divisions. The same result should obtain whether a particular business operation is conducted by a single corporation or a group of related corporations. Taxes, should turn on substance and not form, and this combined report is a valid method of determing the proper apportionable income of the Appellant. In fact, the utilization of the combined report in this instance resulted in the assessment being less than what it would have been had the Appellee not combined the Appellant with these subsidiaries. (Transcript of hearing before Department, October 1, 1973, p. 51). This method is utilized to

determine the proper total net income apportionable to Montana, no matter what the tax consequences.

CONCLUSION

The constitutionality of a Montana statute was not properly raised in this proceeding. Even if constitutional questions may have been raised in the preliminary petition to the Montana Department of Revenue, it is clear that they were abandoned by Appellant and not properly pursued. No substantial federal question has been raised, and therefore whether the Jurisdictional Statement be considered as a Title 28, Sec. 1257(2) appeal or a Section 2103 petition for writ of certiorari, Appellee's Motion to Dismiss on each ground is meritorious and should be granted.

Respectfully submitted,

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APPENDIX A
through
APPENDIX D

APPENDIX A

BEFORE THE
STATE TAX APPEAL BOARD
OF THE
STATE OF MONTANA

IN THE MATTER OF THE PROTEST OF AMERICAN SMELTING AND REFINING COMPANY, a New Jersey corporation, OF PROPOSED DEFICIENCY ASSESSMENTS OF MONTANA CORPORATION LICENSE TAX FOR THE TAXABLE YEARS 1967, 1968, 1969 and 1970

TAXPAYER'S MEMORANDUM

INTRODUCTION

This matter came on regularly for hearing before the Montana State Tax Appeals Board on January 7, 1974, and at that time the Board granted the Taxpayer to and including February 6th, 1974, in which to prepare a Memorandum in reply to the "Brief of Department of Revenue".

ISSUES INVOLVED

From the oral presentation in this matter, it should now be clear to the members of the State Tax Appeal Board that there are only two issues of law still before the Board. First, whether or not under the law the Department of Revenue could combine the Taxpayer and some (but not others) of its affiliated corporations; and, secondly, whether or not income from sources

without the State of Montana were properly reported by the Taxpayer.

CRITICAL ANALYSIS OF THE "BRIEF OF DEPARTMENT OF REVENUE".

We find very little in the brief of the Department of Revenue which requires a reply. The brief is simply a rehash of matters set forth previously in the brief on appeal to the Department of Revenue. The Department of Revenue again takes the position that it is empowered to define the term "unitary business" as it sees fit and having once determined that a taxpayer is "unitary" under its definition, can then proceed to treat all of the income of such a business as subject to apportionment by formula. The Department carries this one step forward and further contends that it can "combine" the income of affiliated corporations without any statutory guidelines.

Of particular significance is the fact that counsel for the Department of Revenue purposefully ignored the case of *Montana Life Insurance Company vs. Shannon*, 106 Mont. 500, 80 P.2d 362, wherein the Montana Supreme Court held that the predecessor section to Section 84-1503, R.C.M. 1947 (previously Section 2297.1, Revised Codes of Montana, 1935), does not come into play where income from "sources within Montana" can be segregated from income from sources "without Montana". Of further significance is the fact that the Department of Revenue has chosen to ignore the newly enacted companion "Corporation Income Tax", and, particularly, Section 84-6903, R.C.M. 1947, which by subsection 2 provides:

> "Income from sources within this state includes income from tangible or intangible property located in or having a situs in this state and income from

> any activities carried on in this state, regardless of whether carried on in intrastate or interstate or foreign commerce."

This latest enactment by the Montana Legislature recognizes that as to intangible properties the old "situs" rules apply.

Section 84-1501, R.C.M., applies the tax to the total net income received by the corporation in the preceding year "from all sources within the State of Montana". Section 84-1503, R.C.M. 1947, provides a rule of apportionment only if the income of a corporation "from sources within the State of Montana cannot be properly segregated from income without the State". Section 84-1504, R.C.M. 1947, provides in pertinent part:

> "The term gross income means the income from all sources within the State of Montana recognized in the determination of the corporation's Federal income tax liability; . . ."

Section 84-1509, R.C.M., defines a unitary business as "one in which the business operations conducted by the corporations in the affiliated group are interrelated or interdependent to the extent that the net income of one corporation cannot reasonably be determined without reference to the operations conducted by the other corporations." Here, the operations of the affiliated corporations which the Department attempts to "combine" with the Taxpayer are separate, are not interrelated or interdependent, and these corporations do not conduct any business within the State of Montana. Federal Metals of Canada conducts all of its business in Canada, cannot file a consolidated return under Federal law, and must file a separate return in Canada. It is impossible to determine by what standards or criteria the Department of Revenue seeks to combine this corporation with

the parent or why the Department has combined some of the affiliates and not others. The Department speaks vaguely of their own definition of a "unitary business" but can point to no statutory authority other than Section 84-1509, R.C.M., which they contend is not controlling.

Most revealing, we feel, was the admission by counsel for the Department at the time of the hearing in this matter that he could not think of one example of "non-business income" under their interpretation of the Uniform Division of Income For Tax Purposes Act.

CONCLUSION

It should be readily apparent to the members of the State Tax Appeal Board that what the Department of Revenue wishes to do with respect to corporations engaged in multistate business is to require such corporations and such of their affiliates as the Department deems proper to report all of the income recognized on their Federal returns and to apportion to Montana by formula all such income. We feel that if the State of Montana is to take such a position, it must be done by legislation. It is submitted that by the use of the term "sources within Montana" with regard to income, the Legislature of the State of Montana has dictated that the rules of situs of income and situs of property are to control and that only where such rules cannot be employed is the apportionment formula to be used. It is quite clear from a reading of the Multistate Tax Compact that under Article 3 the taxpayer has an option to either rely on the rules of situs of income and situs of property or to use the modified rule of the Uniform Division of Income For Tax Purposes Act.

Accordingly, the manner in which the Taxpayer reported its income and the fact that it did not report the income of any of its affiliated corporations was proper and the deficiency assessments based thereon by the Department of Revenue should be set aside.

DATED this 6th day of February, 1974.

AMERICAN SMELTING AND REFINING COMPANY, a New Jersey corporation

ALEXANDER J. GILLESPIE, JR., Vice President and General Counsel
120 Broadway
New York, New York 10005

HUGHES, BENNETT & CAIN
By George T. Bennett
406 Fuller Avenue
P. O. Box 1166
Helena, Montana 59601
ATTORNEYS FOR TAXPAYER

CERTIFICATE OF SERVICE BY MAIL

I, GEORGE T. BENNETT, one of the attorneys for Taxpayer in the above-entitled matter, DO HEREBY CERTIFY that on the 6th day of February, 1974, I served the foregoing TAXPAYER'S MEMORANDUM, by depositing true copies thereof in the United States Mails at Helena, Montana, on said day, securely enclosed in sealed envelopes, with first class certified postage prepaid thereon, one of said envelopes being addressed to each of the following:

Mr. Vernon B. Miller
Administrative Secretary
State Tax Appeal Board
of the State of Montana
1400—11th Avenue
Helena, Montana 59601

and

Mr. Terry B. Cosgrove
Tax Counsel
Department of Revenue
State of Montana
Mitchell Building
Helena, Montana 59601

those being the last known addresses of said persons.

/s/George T. Bennett

APPENDIX B

Rule 34. Petitions for rehearing. When, in appeals or special proceedings, it is ordered that remittitur, peremptory writ or judgment issue forthwith, no petition for rehearing will be entertained. In all other cases a petition for rehearing may be filed within 10 days after the decision of the supreme court has been rendered, unless the time is shortened or enlarged by order, and the adverse party shall have 7 days thereafter in which to serve and file his objections thereto. Extensions of time will be granted only upon showing of unusual merit, and in no event in excess of 10 days. A petition for rehearing may be presented upon the following grounds and none other: That some fact, material to the decision, or some question decisive of the case submitted by counsel, was overlooked by the court, or that the decision is in conflict with an express statute or controlling decision to which the attention of the court was not directed. Oral argument in support of the petition will not be permitted. Six copies of the petition and six copies of objections thereto, which may be in typewritten form, shall be filed with the clerk.

APPENDIX C

IN THE SUPREME COURT
OF THE STATE OF MONTANA

NO. 13249

MONTANA DEPARTMENT OF REVENUE, State of Montana, *Petitioner-Appellant*,

vs.

THE AMERICAN SMELTING AND REFINING COMPANY, *Defendant-Respondent*.

BRIEF OF THE AMERICAN SMELTING AND REFINING COMPANY (ASARCO) IN OPPOSITION TO THE MOTION OF THE MULTISTATE TAX COMMISSION TO PARTICIPATE AS AMICUS CURIAE

Ordinarily an Amicus Curiae motion is not and should not be a contested matter. However, in this particular instance it is ASARCO's attorney's firm conviction and belief that William D. Dexter's Amicus Curiae request on behalf of the Multistate Tax Commission is a sham and a clear abuse of the Montana Rules of Appellate Civil Procedure.

Rule 24 of the Montana Rules of Appellate Civil Procedure requires that an Amicus Curiae motion "shall identify the interest of the applicant." In purported satisfaction of this requirement Mr. Dexter has alleged in his motion that the Multistate Tax Commission's audit of ASARCO "is the subject matter of this litigation," that the Commission's "work product is brought

into controversy by this litigation," and that his participation is necessary so that "comparable laws of the member states [of the Commission] . . . be given a uniform interpretation." These allegations, however, bear little resemblance to the actual issue before this Court on the appeal by the Department of Revenue from the District Court's decision in favor of ASARCO.

It is true that the audit which formed the basis of this litigation was conducted by the Multistate Tax Commission. But this fact has no bearing whatsoever on the issue on appeal herein. There never was any question in this case as to the audit information. Thus, the issue on appeal does not relate to the validity of the mechanics of the audit. Rather, the issue on the Department's appeal concerns the time at which the principles of UDITPA became effective in Montana. This issue, ASARCO submits, is solely and exclusively one of Montana law, in which the Multistate Tax Commission has not one bit of interest and with respect to which there is no need whatsoever for "uniform interpretation and application by the member states" of the Multistate Tax Commission.

The sham nature of the Multistate Tax Commission's Amicus Curiae motion rests on the fact that William D. Dexter has been appointed a Montana Special Assistant Attorney General for the Montana Department of Revenue for a controversy between the Department of Revenue and W. R. Grace and Company, in which the central issue, as in this case, is the effective date of UDITPA in Montana. In fact, there is presently under submission in the District Court of the First Judicial District a Motion for Summary Judgment by W. R. Grace which is opposed by William D. Dexter, as attorney for the Department of Revenue. The question in the W. R. Grace litigation is whether under the District Court's

decision in this case certain interrogatories based on UDITPA are relevant, in light of the District Court's decision in this case that UDITPA was not applicable during the tax years in question.

As previously noted, there is no real interest on behalf of the Multistate Tax Commission in the issue on this appeal, which concerns the effective date of UDITPA in Montana. In light of the fact that William D. Dexter is an attorney for the Department of Revenue with respect to the W. R. Grace litigation, which involves the same issue with respect to the effective date of UDITPA, it is clear that Mr. Dexter's request to participate in this appeal as Amicus Curiae is nothing more than an attempt to give the Department of Revenue the opportunity to in effect submit two briefs in support of its appeal. This, ASARCO submits, is a patent abuse of the Montana Rules of Appellate Civil Procedure. If, as Mr. Dexter claims, he would be able to "be of aid to the Court in properly resolving the issues in this litigation", then the proper channel for his input is through his fellow Department of Revenue Counsel who are handling the ASARCO appeal, and not, as has been requested, through the sham medium of an Amiens Curiae brief on behalf of the Multistate Tax Commission.

As this Court said in *State ex rel. Bennett v. Bonner, Gov.*, 123 Mont. 414, 420-21, 214 P.2d 747 (1950):

> "An 'amicus curiae' literally meaning a friend of the court is a person, whether attorney or layman, who, as a standerby, when a judge is doubtful or mistaken, may upon leave granted in a case then before him, inform the court as to facts or situations that may have escaped consideration or remind the court of a legal matter which has escaped its notice and regarding which it appears to be in danger of going wrong.

> The right to be heard as amicus curiae is within the discretion of the court and is in nowise dependent upon the consent of the parties to the proceeding.
>
> An amicus curiae may be appointed by the court sua sponte or he may appear by leave of court. An amicus curiae is not a party to the action, — he has no control over the proceedings, — he must take the case as he finds it, and under the rule that the constitutionality of a statute may not be attacked by one whose rights are not affected by the operation of the statute, an amicus curiae has no right to question the constitutionality of an act and the court will not pass on grounds of invalidity urged by an amicus curiae but not presented by the parties.
>
> The statements of an amicus curiae are to be weighed and tested like other evidence, and it is within the discretion of the court as to whether it will accept the advise or suggestions of an amicus curiae."

Here Mr. Dexter is not "a standerby" but a partisan advocate and attorney for the Department of Revenue who can and should be required to participate in the presentation of this matter by cooperating with his fellow attorneys for the Department. There has been more than ample opportunity for his participation in the brief of the Department. The Department should not be allowed by this sham to file two briefs (especially since it has already, with permission, exceeded the allowed brief length).

In any event, even if the Court should allow Mr. Dexter to participate as Amicus Curiae, it would only be fair, in light of Mr. Dexter's position with the Department with respect to the W. R. Grace litigation, that the Court further order that ASARCO's brief on this appeal

shall not be due until 30 days after service of the Amicus Curiae brief. ASARCO submits that such an order is the only way by which it could be given some measure of protection from the "two briefs" technique attempted by the Department in this case.

Finally, it should be noted that Mr. Dexter has requested leave to participate in oral argument as Amicus Curiae. Rule 24 expressly requires that such leave "will be granted only for extraordinary reasons". ASARCO submits that even if the Court should grant leave for an Amicus brief on behalf of the Multistate Tax Commission, Mr. Dexter's motion clearly does not present "extraordinary reasons" which would justify his participation in oral argument.

For the foregoing reasons ASARCO respectfully submits that (1) the Multistate Tax Commission's motion for leave to participate in this appeal as Amicus Curiae should be denied, or (2) in any event, if leave to participate as Amicus Curiae is granted to the Multistate Tax Commission, then the time at which ASARCO's brief on appeal is due should be extended to 30 days after service of the Amicus brief, and, in addition, counsel for the Multistate Tax Commission should not be permitted to participate in oral argument as Amicus Curiae. A proposed order is attached.

DATED this 12th day of May, 1976.

HUGHES, BENNETT & CAIN
STUART L. KELLNER
JOHN F. SULLIVAN

/s/George T. Bennett
406 Fuller Avenue
P. O. Box 1166
Helena, Montana 59601

IN THE SUPREME COURT
OF THE STATE OF MONTANA

NO. 13249

MONTANA DEPARTMENT OF REVENUE, State of Montana, *Petitioner-Appellant*,

vs.

THE AMERICAN SMELTING AND REFINING COMPANY, *Defendant-Respondent*.

AFFIDAVIT OF GEORGE T. BENNETT IN SUPPORT OF BRIEF OF ASARCO IN OPPOSITION TO THE MOTION OF THE MULTISTATE TAX COMMISSION TO PARTICIPATE AS AMICUS CURIAE

George T. Bennett, being first duly sworn, deposes and says:

1. He is the counsel of record for ASARCO in the above-entitled matter, and, in addition, is the counsel of record for W. R. Grace and Company in *W. R. Grace and Company vs. The Montana Department of Revenue*, First Judicial District Civil Number 38977.

2. William D. Dexter, who has petitioned for leave to participate as Amicus Curiae in the above-entitled matter, was on March 21, 1975 appointed as a Special Assistant Attorney General for the State of Montana for the purpose of handling the controversy referred to above between the Department of Revenue and W. R. Grace and Company.

3. There is currently under submission in the First Judicial District, in Civil Action Number 38977, a motion for summary judgment by W. R. Grace by which

W. R. Grace contends that it need not answer certain interrogatories served by William D. Dexter in conjunction with the W. R. Grace controversy. The Department has admitted that these interrogatories are all based on UDITPA. W. R. Grace has contended, *interalia*, that the interrogatories are irrelevant because, according to the District Court's decision in this case, UDITPA was not effective in Montana during the tax years in question.

4. The legal question on the appeal in this case is identical to that involved in the W. R. Grace litigation, which, from the outset, has been handled by William D. Dexter, who has petitioned for leave to participate as Amicus Curiae in this case on behalf of the Multistate Tax Commission.

5. At the time of William D. Dexter's appointment as a Special Assistant Attorney General for Montana, in March, 1975, this case was pending in the District Court of the First Judicial District, and the parties were then in the process of preparing and filing briefs in support of their respective positions. This case was not taken under submission by the District Court until late in November, 1975, and was not finally decided by the District Court until December 17, 1975. The Department of Revenue's opening brief on this appeal was first due in February, 1976. However, the Department requested and obtained three extensions of time and its opening brief was not filed until April 22, 1976. During this time William D. Dexter was fully aware of the District Court decision and the appeal in this matter. Nevertheless, Mr. Dexter's request for leave to participate as Amicus Curiae was not filed with this Court until May 10, 1976.

DATED this 12th day of May, 1976.

George T. Bennett

SUBSCRIBED and sworn to before me this 12th day of May, 1976.

Donna S. Muffick
Notary Public for the State of Montana
Residing at Helena, Montana
My Commission Expires July 21, 1978

IN THE SUPREME COURT
OF THE STATE OF MONTANA

NO. 13249

MONTANA DEPARTMENT OF REVENUE, State of Montana, *Petitioner-Appellant*,

vs.

THE AMERICAN SMELTING AND REFINING COMPANY, *Defendant-Respondent*.

ORDER DENYING THE MULTISTATE TAX COMMISSION'S MOTION TO PARTICIPATE AS AMICUS CURIAE

A Motion having been made by William D. Dexter, Special Assistant Attorney General for the State of Montana and General Counsel for the Multistate Tax Commission, and opposition having been filed by the American Smelting and Refining Company, Defendant-Respondent, and due consideration having been given to said motion and opposition,

IT IS HEREBY ORDERED that the motion of the Multistate Tax Commission for leave to participate as Amicus Curiae in the above-captioned action be and the same is hereby denied.

DATED this _____ day of May, 1976.

CHIEF JUSTICE

CERTIFICATE OF SERVICE BY MAIL

I, GEORGE T. BENNETT, one of the attorneys for Defendant-Respondent AMERICAN SMELTING AND REFINING COMPANY in the above-entitled action do hereby certify that on the 12th day of May, 1976, I served the attached BRIEF OF ASARCO IN OPPOSITION TO THE MOTION OF THE MULTISTATE TAX COMMISSION TO PARTICIPATE AS AMICUS CURIAE, AFFIDAVIT OF GEORGE T. BENNETT, and PROPOSED ORDER, by depositing true copies thereof in the United States Mails at Helena, Montana, on said day, securely enclosed in three sealed envelopes, with first class postage prepaid thereon, said envelopes being addressed to each of the following:

Theodore W. de Looze
Special Assistant Attorney General
Department of Justice
State Office Building
Salem, Oregon 97310

Terry B. Cosgrove
Special Assistant Attorney General
P. O. Box 1144
Helena, Montana 59601

the attorneys for Petitioner-Appellant, Montana Department of Revenue, State of Montana; and

William D. Dexter
Attorney at Law
Bank of Olympia Building
Olympia, Washington 98501

the attorney for the Multistate Tax Commission; these being the last known addresses of said attorneys.

/s/George T. Bennett

APPENDIX D

NO. 37750

IN THE
SUPREME COURT
OF THE
STATE OF MONTANA

MONTANA DEPARTMENT OF REVENUE, STATE OF MONTANA, *Petitioner-Appellant*,

vs.

THE AMERICAN SMELTING AND REFINING COMPANY, *Defendant-Respondent*.

APPELLANT'S BRIEF

Appellant's Brief on Appeal from the District Court of the First Judicial District of the State of Montana, in and for the County of Lewis and Clark.

(Material on pp. 1-7 of original document omitted).

In arriving at its total net income, ASARCO deducted as business expenses all expenses attributable to the production of dividends, interest, royalties, rents and gains from the sale of property, rather than attributing such expenses to the production of such income. For example, ASARCO maintains company housing at some of its mines. The costs of such housing, such as depreciation, taxes, interest, management, maintenance and repairs were deducted as business expenses from general operating expenses: Thus, Montana's share of apportionable net income was reduced twice, under ASARCO's

method, once by deducting such expenses, and then by deducting the gross rentals which recovered such expenses.

As shown by ASARCO's Montana tax returns (Ex. "A" through "D"), the tax computations were:

1967

Federal Taxable Income	$60,527,768
Nonbusiness Income Deducted	45,169,221
Apportionable Income	$15,358,547

Apportionable income (or loss) was apportioned to Montana by a three-factor formula to determine the percentage attributable to Montana sources:

$$\frac{\text{Montana Property}}{\text{Property Everywhere}} + \frac{\text{Montana Payroll}}{\text{Payroll Everywhere}} + \frac{\text{Montana Sales}}{\text{Sales Everywhere}} = \text{_____}\%$$

Averaged by dividing by 3

Montana percentage (1.7674) x $15,358,547 =	$	271,447
Income from Montana securities allocated to Montana		6,385
Net Income from Mon- Sources	$	277,832

	1968		
Federal taxable income	$ 62,531,929		
Nonbusiness income deducted	62,548,620		
Apportionable loss	(16,691)		
Loss apportioned to Montana	(307)	(1.8367%)	
Income from Montana securities allocated to Montana	7,288		
Net income from Montana Sources.....	$ 6,981		
	1969		
Federal taxable income	$ 92,480,382		
Nonbusiness income deducted	76,869,974		
Apportionable income	15,610,408		
Income apportioned to Montana	302,982	(1.9409%)	
Income from Montana securities allocated to Montana	3,082		
Net income from Montana Sources.....	$ 306,064		
	1970		
Federal taxable income	$115,219,427		
Nonbusiness income deducted	115,584,872		
Apportionable loss	(365,445)		
Loss apportioned to Montana	(7,324)	(2.0042%)	
Income from Montana securities allocated to Montana	4,903		
Net loss from Montana Sources.....	$ (2,421)		

(Material on pp. 10-53 of original document omitted).

Respectfully submitted,

/s/THEODORE W. DE LOOZE
Special Assistant Attorney General
Department of Justice
State Office Building
Salem, Oregon 97310

/s/TERRY B. COSGROVE
Special Assistant Attorney General
P. O. Box 1144
Helena, Montana 59601

Attorneys for Petitioner-Appellant

Supreme Court, U. S.
FILED
DEC 5 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO INCORPORATED (formerly
The American Smelting and Refining Company),
Appellant,

v.

MONTANA DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA, *Appellee.*

**On Appeal from the
Supreme Court of Montana**

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO INCORPORATED (formerly The American Smelting and Refining Company), *Appellant,*

v.

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee.*

On Appeal from the Supreme Court of Montana

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

I. INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce as amicus curiae in support of the jurisdictional statement in the above-captioned case. Both parties to this proceeding have consented to the filing of this brief, as evidenced by the letters reproduced as Exhibit A, pages 1a-2a, *infra.*

II. OPINIONS BELOW

The opinion of the Supreme Court of the State of Montana is reported at 567 P.2d 901 (1977). Copies of that opinion, the Supreme Court of Montana's denial of a petition for rehearing, and the unreported findings of fact and opinions of the District Court for the First Judicial District of the State of Montana and the State Tax Appeals Board of the State of Montana (both of which ruled for appellant) are appended to Appellant's Jurisdictional Statement as Appendix A.

III. INTEREST OF AMICUS CURIAE

The Council of State Chambers of Commerce (COUNCIL), organized in 1932, consists of 33 Chambers of Commerce (29 state and 4 regional Chambers). The Committee on State Taxation (COST), one of four advisory committees of the COUNCIL, consists of 110 corporate members which conduct a substantial portion of the interstate and international business of the United States. One of COST's principal activities has been to work with the states and others toward developing fair and equitable national standards in the income allocation and apportionment aspects of state taxation.

Member companies of COST are thus representative of that part of the nation's business section which is most directly affected by state taxation of interstate and international business operations. COST is therefore vitally interested in cases such as this one which present issues significantly affecting the uniformity, certainty and fair apportionment of state and local taxes.

The particular interest of COST in this case is that it presents the following substantial questions:

(1) Whether a member state of the Multistate Tax Compact, acting in conjunction with the Multistate Tax Commission, may lawfully impose taxes pursuant to an audit by the Multistate Tax Commission acting under the purported authority of the Multistate Tax Compact if this Court rules that the Compact is unconstitutional in *United States Steel Corp.* v. *Multistate Tax Commission,* Dkt. No. 76-635, prob. juris. noted, 429 U.S. 1088 (1977).

(2) Whether a state may, consistently with the Constitution's Commerce and Due Process Clauses, subject a corporation doing business in that state, but domiciled elsewhere, to a license or income tax on investment income of the corporation which is earned outside of that state and has no connection with the business conducted in that state.

(3) Whether, consistently with the above provisions of the Constitution, a state may impose a license or income tax under a so-called "combined report" theory which has the effect of subjecting a corporation doing business in that state to tax on the income of its United States and foreign affiliates even though the affiiiates conduct no business in that state and derive all of their income from sources outside of that state.

Reaffirmation by this Court of the constitutional standards for fair apportionment in state taxation of multistate and multinational businesses in cases of this type is urgently needed for the orderly growth of interstate and international commerce. It is also needed to provide a reasonably consistent and fair system of

taxation throughout the nation in this era of rapidly increasing state and local revenue demands, which system will allow each state to receive its just share of the total tax contribution of the nation's business sector. Finally, such review by this Court is absolutely essential in view of the existence of the Multistate Tax Compact, a confederation of 19 western states created for the acknowledged purpose of blocking Congress—the only avenue other than this Court available for resolution of the interstate tax problem—from enacting any legislation to protect interstate and foreign commerce from discriminatory state taxation.

IV. ARGUMENT

A. The Need for Constitutional Standards

It has been eighteen years since this Court last decided a case involving the constitutional limits on a state's power to tax the income of an out-of-state corporation doing business within the state and admittedly subject to its taxing jurisdiction. See *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959). Cf. *General Motors Corporation* v. *District of Columbia,* 380 U.S. 553 (1965). During that eighteen year period, the worst features of our complex and inequitable interstate tax system have worsened[1] as social, economic and political pressures have combined to place ever-increasing demands upon our state treasuries.[2] The response of many state tax officials to these

[1] Hearings Before the Subcommittee on State Taxation of Interstate Commerce of the Senate Committee on Finance, 93rd Cong., 1st Sess. 260-284 (1973); Cahoon and Brown, "The Interstate Tax Dilemma", 26 *National Tax Journal* 187 (1973).

[2] State tax collections totaled $89.3 billion in 1976 compared to $24.2 billion in 1964. State corporate income tax collections are now more than 16% of federal corporate income tax collections; in 1966, state collections were only 7%.

pressures has been to probe the outer limits of the state taxing power by applying arbitrary and expansive definitions of that power. As Justice Frankfurter stated in his dissent in *Northwestern States Portland Cement Co.* v. *Minnesota, supra,* 358 U.S. at 477, "[t]he solution to these [interstate tax] problems ought not to rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources."

It is not uncommon for officials of the Multistate Tax Commission—the most important contributor to the impetus toward extraterritorial taxation—to decry any proposed restriction on the Commission's efforts to transform the interstate tax system as threatening the states with serious injury or destruction.[3] When such a siege mentality prevails it is understandable that the self-serving determination to maximize revenues may overcome long-established constitutional

[3] For example, see the testimony of John Lobdell, Chairman of the Multistate Tax Commission, before the Foreign Relations Committee in opposition to the pending U.S.-United Kingdom Tax Treaty. Hearings on the Convention with the United Kingdom for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains before the Senate Comm. on Foreign Relations, 95th Cong., 1st Sess. (1977) (not yet printed) [hereinafter cited as Treaty Hearings].

The Ninth Annual Report of the Multistate Tax Commission, p. 9 (1976), stated:

> "The Treasury Department has included in the pending tax treaty with the United Kingdom provisions which would shackle the States in their efforts to improve their tax administration capabilities . . . . Similar provisions are being incorporated into treaties which are currently being negotiated with other nations."

principles defining jurisdiction to tax. It is unlikely under these conditions that self-discipline will prove sufficient to contain within constitutional limits the gradual expansion of the area in which state taxing power is asserted.[4] To the contrary, it is abundantly clear that the member states of the Multistate Tax Compact, in conjunction with the Multistate Tax Commission, will continue to expand those boundaries until this Court announces that a constitutional limitation has been exceeded.

The aggressive approach taken by some states in recent years is reflected by the Court's present docket, which includes a variety of important cases presenting, in combination, most of the important issues in this area. These cases include:

> *United States Steel Corp.* v. *Multistate Tax Commission,* Dkt. No. 76-635, prob. juris. noted, 429 U.S. 1088 (1977), which questions the extent to which the states may combine without congressional consent to control the taxation of interstate and foreign commerce through the Multistate Tax Compact and the Multistate Tax Commission;

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[4] For example, notwithstanding the thrust of this Court's decision in the *General Motors* case, *supra,* Florida, Wisconsin, New York and Massachusetts have all taken steps since 1971 to shift their rising tax burdens to out-of-state businesses by giving *double* weight to the sales factor in the three-factor formula customarily used to apportion interstate business income. 10B Fla. Stat. Ann. § 220.15(4) (Supp. 1977); 2B Mass. Ann. Laws, Ch. 63, § 38 (Supp. 1977); N. Y. Tax Law § 210.3 (McKinney Supp. 1976); Wis. Stat. Ann. § 71.07 (Supp. 1977). In addition, a bill providing for double weighting of the sales factor was introduced in the Illinois Senate on April 7, 1977. The bill, S.B. 737, came up for a final vote by the Senate on May 26, 1977, but was recommitted to the Senate Revenue Committee for further study of its revenue impact.

> *Moorman Mfg. Co.* v. *Bair,* Dkt. No. 77-454, prob. juris. noted, —— U.S. —— (Nov. 14, 1977), which concerns the constitutional validity of an income-apportionment formula based entirely on sales;
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> *Chase Brass & Copper Co.* v. *Franchise Tax Board,* Dkt. No. 77-582 (docketed Oct. 20, 1977), which questions the validity of a "combined reporting" theory under which the income of a company not subject to a state's taxing power may be apportioned and taxed to a related company doing business within the state; and
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> The instant case, which questions the validity of (i) a state tax imposed on investment income earned outside the state by a foreign corporation doing business within the state, (ii) a *Chase Brass* "combined reporting" adjustment and (iii) a Multistate Tax Commission audit under the Multistate Tax Compact, the constitutionality of which is currently at issue before this Court in the *U.S. Steel* appeal.

It is submitted that this spectrum of problems will continue to confront this Court, and taxpayers will be faced with ever-broader assertions of state power, until the Court agrees to consider and resolve the above issues. Given the vagaries of litigation, however, the Court may not again be presented with so complete an assortment of state income tax issues on a single docket. Thus, the Court has an opportunity to consider these important and interrelated issues together, rather than in isolation, and to provide definitive constitutional guidance which will greatly reduce the burden of administering and litigating the validity of state tax stat-

utes for years to come. COST therefore strongly urges the Court to accept this opportunity.

Our specific views on the three issues in the instant case are as follows:

B. Extraterritorial Investment Income

1. Origin of the Multistate Tax Commission's Rule

The Multistate Tax Compact, a confederation of 19 states,[5] was created in 1967 in response to the enactment by Congress of P.L. 86-272 (Act of September 14, 1958, 73 Stat. 555)[6] and the subsequent congressional report, which was highly critical of the states' handling of the multistate tax problem and which urged a congressional solution.[7] The Compact was created for the acknowledged purpose of "killing off" any further federal legislation dealing with protection of interstate and foreign commerce from discriminatory state taxation, thereby leaving the resolution of the problem to this Court.[8]

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[5] The member states are: Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington.

[6] This statute, which was adopted by Congress as a stop-gap measure, established minimum jurisdictional standards for state taxation, 15 U.S.C. §§ 381-384 (1970), and directed that a congressional investigation of interstate taxation be made. 15 U.S.C. § 381 n. (1970).

[7] Report of the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary, H.Rep. No. 1480, 88th Cong., 2d Sess., Vol. 2, p. 559 (1964). See also the other volumes of the Report: H. Rep. No. 1480, 88th Cong., 2d Sess.. Vol. 1 (1964); H. Rep. No. 565, 89th Cong., 1st Sess., Vol. 3 (1965); H. Rep. No. 952, 89th Cong., 1st Sess., Vol. 4 (1965).

[8] Statement of Eugene Corrigan, Executive Director of Multistate Tax Commission, in "Taxation of Interstate Business", *Proceedings of Tax Foundation, Seminar* (April 16-17, 1970), p. 17. See also Multistate Tax Commission, First Annual Report, p. 1 (1968).

The Compact creates the Multistate Tax Commission, an independent administrative body empowered to promulgate regulations and adopt practices to implement the interstate tax policies of the Compact. The Compact grants the Multistate Tax Commission broad subpoena powers as well as the power to conduct interstate tax audits.

The draftsmen of the Compact copied the Uniform Division of Income for Tax Purposes Act (UDITPA), 7 U.L.A. 365 (1970), a model statute approved in 1957 by the National Conference of Commissioners on Uniform State Laws. Under UDITPA, passive, nonbusiness income items such as royalties, interest and dividends on investments are allocated to the appropriate state according to situs. All of the remaining income is then labeled business income and is apportioned according to an equally-weighted three-factor formula among the states with jurisdiction to tax such income. Although the Compact copies UDITPA, the Multistate Tax Commision has promulgated regulations and practices that obliterate the key elements of UDITPA by calling for full apportionment of the non-business income of multistate taxpayers, thereby eliminating the distinction provided by UDITPA between non-business and business income.[9]

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[9] Multistate Tax Newsletter, No. 30, issued by the Multistate Tax Commission, September, 1971. The Multistate Tax Commission in its Seventh Annual Report (1974) explained its action as follows: "Full apportionment involves applying the [apportionment] formula to all income *regardless of source or nature*". (Emphasis supplied; p. 47.)

Traditionally, passive non-business income, such as royalties, interest and dividends on investments, is specifically allocated for purposes of state corporate income tax to the state where the recipient has its corporate domicile.[10] This means that, under traditional interstate practice, passive non-business income is subject to taxation only in the state of domicile. Such income, not being earned by the business operations of the taxpayer, is not subject to tax through apportionment in other states where those operations are conducted.

Eugene Corrigan, Executive Director of the Multistate Tax Commission, has noted that the traditional interstate tax practice of allocation of passive-type investment income according to its situs was initially developed by states on the eastern seaboard, which has been "the situs of the corporate movement in America." [11] Corrigan indicated that the development of the corporation required "the concomitant devising of a tax system appropriate for corporations." The traditional interstate tax practice of specific allocation of passive, non-business income, therefore, evolved as the system most "appropriate for corporations."

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[10] For cases illustrating the operation of this traditional practice, see, e.g., *Avco Corp.* v. *Wasson*, 230 S.E.2d 614 (S.C. 1976); *American Bakeries Co.* v. *Johnson*, 259 N.C. 419, 131 S.E.2d 1 (1963); *Cargill, Inc.* v. *Spaeth*, 215 Minn. 540, 10 N.W.2d 728 (1943); *California Baking Corp.* v. *State Tax Commission*, 97 Utah 367, 93 P.2d 463 (1939). A tax policy research study published by the U.S. Treasury in 1976 also indicates that allocation of non-business income is the long-standing method of taxation employed by the states. See *Essays in International Taxation*, p. 201 (1976).

[11] Multistate Tax Commission, Seventh Annual Report, p. 46 (1974).

The 19 members of the Multistate Tax Compact, on the other hand, are primarily western states with few large commercial centers within their boundaries. No eastern industrial state is a member. The members of the Compact are opposed to the traditional practice with respect to allocation of non-business income because it conflicts with their own "self-serving determinations" as to "what they are entitled to out of the Nation's resources." Accordingly, the Multistate Tax Commission, pursuant to Article IV of the Compact, promulgated regulations eliminating this traditional legal system and adopting instead the full apportionment by formula of all interstate income.

The Montana tax involved in this appeal was assessed pursuant to an audit by the Multistate Tax Commission of Appellant's Montana tax returns. The assessment was based upon the Multistate Tax Commission's regulations requiring full apportionment of all income rather than upon the controlling Montana statute (Section 84-1503, R.C.M. 1947) requiring separate allocation of non-business income according to situs as required by UDITPA.

The background and purpose of UDITPA and the Multistate Tax Commission's deliberate attempt to misconstrue it were recently summarized in Garrison, "Toward a Consensus on Apportionable vs. Allocable Income", 28 *The Tax Executive* 41 (October, 1975), as follows (footnotes omitted):

> "The problem of dividing the total net income of a multistate firm among the states entitled to impose a tax on it has existed ever since Wisconsin enacted the first modern state net income tax in 1911. For all those years this problem has been the subject of study and comment.
>
> * * *

The National Tax Association has wrestled with the problem of allocation and apportionment for more than a half century. As early as 1922, an NTA committee recommended specific allocation of interest, dividends, rents, and royalties to their geographic source. Their report declared: 'They form no part of the trading profit and do not need to be apportioned by formula since they can readily be specifically allocated to their proper sources'.

In 1957, the National Conference of Commissioners on Uniform Laws adopted the Uniform Division of Income for Tax Purposes Act (commonly referred to as UDITPA), which has since been enacted by over half the states. Under UDITPA, non-business income is allocated, item by item, to each appropriate state according to the situs of the item. All of the remaining income is then labeled business income and is apportioned, according to a three-factor formula, among the states with jurisdiction to tax such income.

Business income is defined in UDITPA as income arising from transactions and activity in the regular course of the taxpayer's trade or business, including income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

The classes of income which are to be specifically allocated under UDITPA, if they do not constitute business income for the taxpayer, are dividends, interest, rents and royalties, and capital gains.

At the time UDITPA was adopted, the statutes and administrative practices for most of the states required direct allocation to specific states of dividends, royalties, and interest income especially where such income had not arisen in the main course of the taxpayer's trade or business. There

was a rather extensive body of case law and literature in support of this traditional legal position. The framers of UDITPA were aware of these precedents and practices but, as indicated by Sections 4 through 8 of the Act, they evidently preferred to make no radical departure from existing law and administrative practices with respect to allocation and apportionment.

Professor William J. Pierce, the principal draftsman of the Uniform Act (UDITPA), has indicated that the distinction between business and nonbusiness income in the act and was intended to codify the existing pattern of legislation. In an article in 35 *Taxes—The Tax Magazine* 749 (1957), Professor Pierce stated:

> 'Sections 4 through 8 of the act provide for the allocation of four types of non-business income to specific states, rather than apportionment on the basis of a formula. The reason for this treatment, which is representative of the existing pattern of legislation, is that it is felt that these items of income can appropriately be attributed to a specific state.'

* * *

The push for full apportionment of all income by formula perhaps had its origin in 1966 with the so-called Interstate Taxation Bill (H.R. 11798, 89th Cong., 2d Sess.), which was introduced in Congress soon after the publication of the Willis committee report. Under this so-called Willis bill, the entire income, both business and nonbusiness, had to be divided among the states by a uniform apportionment formula. This radical departure from the prevailing practice with respect to allocation was one of the most controversial parts of the Willis bill.

The momentum for Congressional legislation starting with the Willis bill caused the formation

in 1967 of the Multistate Tax Compact, a confederation of 21 states created primarily for the purpose of blocking the enactment of any federal legislation with respect to the interstate tax problem. Article IV of the Compact adopts the Uniform Act (UDITPA) as its rules governing allocation and apportionment. However, the Multistate Tax Commission, which is created under the Compact, adopted regulations in 1971 requiring virtual full apportionment of all income, irrespective of the class of income or its geographic source. Sections 4 through 8 of the Uniform Act (UDITPA) were simply read out of the statute by regulation. The Commission's regulations instead reflect the view that all of a corporation's interstate taxable income is business income and should, therefore, be apportioned."

The Multistate Tax Commission immediately recognized that its adoption on June 19, 1971 of regulations eliminating the distinction between business and non-business income would conflict not only with UDITPA but also with the various state tax statutes. As evidence of this recognition, the Commission adopted at the same meeting a resolution urging that Article IV of the Compact as well as the laws of the member states be revised to conform to the Multistate Tax Commission's regulations.[12] However, neither the Compact nor the statutes of member states (including Montana) have been amended as suggested by the Commission.

Mr. William D. Dexter, Chief Counsel of the Multistate Tax Commission, discussed this attempt to bypass UDITPA in Dexter, "Taxation of Income from Intangibles of Multistate-Multinational Corporations", 29 *Vand. L. Rev.* 401, 407 (March, 1976):

[12] Multistate Tax Newsletter, No. 30 (September, 1971).

"The UDITPA distinction between 'business' and 'non-business' corporate income appears to lack any rational basis and has created confusion for taxpayers and tax administrators alike. The Multistate Tax Commission has, therefore, concluded that the distinction should be eliminated by treating all corporate income as apportionable business income.* * * Since UDITPA, an integral part of the Compact, specifically contemplates the designation of at least some income as non-business income, and since the Multistate Tax Commission is reluctant to recommend amendments to the Compact that would be necessary to implement the 'full apportionment' concept under UDITPA, the Commission has chosen to rely for the present upon its regulations to clear up as much of the confusion as possible."

This statement by the Multistate Tax Commission's Chief Counsel is tantamount to an admission that the Commission is trying to change *state* law through *Commission* regulations.

In a letter dated September 24, 1971, Eugene Corrigan, Executive Director of the Multistate Tax Commission, stated with respect to the Commission's regulations:

"While none of you apparently like to see full apportionment of all corporate taxable income, many of you on the business as well as the state side are concerned about the problems which may arise legally in making the change."[13]

The utter failure to heed the concerns conceded by Corrigan is what gave rise to this case.

[13] Hearings Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Comm. on Finance, 93rd Cong., 1st Sess., 269-270 (1973).

As noted above, the Multistate Tax Compact includes UDITPA's allocation rules. Accordingly, when the various state legislatures adopted the Compact, they also adopted UDITPA. Now, without further action by the legislatures, the Multistate Tax Commission is attempting, through its regulatory power, to completely vitiate that legislative intent. This is, perhaps, the most insidious danger of the Multistate Tax Compact, *i.e.*, the Commission's issuance of regulations without regard to legislative intent, its implementation of those regulations through its joint audit program and its attempt to force such audits upon taxpayers through its subpoena power. The presence of such awesome cumulative powers in a body lacking political responsibility to the electorate is a threat to federal supremacy and to the sovereignty of the states themselves.

2. Constitutional Standards

Notwithstanding the Multistate Tax Commission's "confusion", the UDITPA provisions are consistent with the long-standing constitutional doctrine that a state cannot tax income "in no just sense attributable to transactions within its jurisdiction". *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123, 134 (1931). See *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113 (1920).

The Fourteenth Amendment to the Constitution provides that "No State shall . . . deprive any person of life, liberty, or property, without due process of law . . . ." As corporations are "persons" within the meaning of the Fourteenth Amendment (*Pembina Consolidated Silver Mining and Milling Co.* v. *Pennsylvania,* 125 U.S. 181 (1888)), it follows that states cannot compel corporations to pay taxes without due process.

The applicability of the Due Process Clause to state tax matters was discussed in *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U.S. 77 (1938). In that case, where California was prevented from imposing its gross premium tax on a Connecticut corporation's non-unitary, non-California reinsurance contracts, Justice Stone stated:

> "[T]he limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state. As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it. Hence it is that a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there may tax them. But *the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere.*" [Emphasis supplied; 303 U.S. at 80-81]

It is a constitutional axiom that state taxation of foreign corporations doing business in the state must be limited so as to avoid taxation of extraterritorial values. As this Court stated in *Norfolk & Western Ry. Co.* v. *Missouri State Tax Commission,* 390 U.S. 317, 325 (1968):

> "The taxation of property not located in the taxing State is constitutionally invalid, both because it imposes an illegitimate restraint on interstate commerce and because it denies to the taxpayer the process that is his due. A State will not be permitted, under the shelter of an imprecise alloca-

> tion formula or by ignoring the peculiarities of a given enterprise, to 'project the taxing power of the state plainly beyond its borders'. *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State. *Fargo* v. *Hart,* 193 U.S. 490, 499-500 (1904)." [Footnotes omitted.]

In determining the situs of intangibles, the basic constitutional rule is "mobilia sequuntur personam" (*i.e.,* movables follow the person). Thus, intangibles are "localized at the owner's domicile for purposes of taxation" if they do not have a "business situs" in another state. *Wheeling Steel Corp.* v. *Fox,* 298 U.S. 193 (1936); *First Bank Stock Corp.* v. *Minnesota,* 301 U.S. 234 (1937); *Curry* v. *McCanless,* 307 U.S. 357 (1939); *Chestnut Securities Co.* v. *Oklahoma Tax Commission,* 125 F.2d 571 (10th Cir. 1942), *cert. denied,* 316 U.S. 668 (1942).

On the other hand, formulary apportionment of the *trading profits* of a business is accepted as constitutionally sound in the ordinary case because it is frequently difficult to ascertain in any other way the income from in-state business activities which constitute one or more steps in a series of transactions culminating in the realization of income outside the state. See *Skelly Oil Co.* v. *Commissioner of Taxation,* 269 Minn. 351, 131 N.W.2d 632 (1964); UDITPA, *supra.* If the amount of in-state income depends on accounting hypotheses or an assumed division of income between branches of an integrated business, this Court justifiably refrains from intervening on the side of the corporate taxpayer simply because its calculation of in-state income varies from that of the taxing authorities.

There is a limit, however, to the extent to which expediency can allow a state to disregard jurisdictional limits. Where income arises from a distinct and identifiable source, it can and should be specifically allocated (*i.e.,* attributed or assigned) to that source because this will produce the most accurate and precise determination of the taxpayer's true tax liability. If a specific allocation can be made because there is no dispute as to the source of the income item in question, apportionment by formula is not necessary and should not be permitted.

3. Appellant's Investment Income Is Not Taxable In Montana

In the present case, Appellant reported and paid Montana tax on the investment income it earned from money on deposit in Montana and securities deposited with Montana agencies. It allocated its remaining investment income to the state of its commercial domicile or the state where the investment property was located. See J.S., App. A, pp. 22a-23a.[14] Both the State Tax Appeal Board and the State District Court found as a fact that *all* of Appellant's remaining investment income was derived from sources outside Montana and could, as a practical matter, be "segregated" from the income earned within Montana. J.S., App. A, pp. 23a, 43a.

None of Appellant's investment property was functionally related in any fashion to the conduct of Appellant's business activities *in Montana.* On this record, it is indefensible to "apportion" any of such investment

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[14] J.S. references are to the Appendix to Appellant's jurisdictional statement.

income to Montana. However, the Montana Supreme Court has approved that treatment by characterizing the investment income as "business" income which was allegedly related in various indirect ways to Appellant's business activities *outside* Montana, thereby upholding the Multistate Tax Commission's practice of treating *all* income as business income subject to formula apportionment regardless of the state taxing statute. See J.S., App. A, pp. 11a-13a.

Similar attempts to tax an out-of-state corporation on investment income have been firmly rejected by state Supreme Courts in *Square D Co.* v. *Kentucky Board of Tax Appeals,* 415 S.W. 2d 594 (Ky. 1967); *Gulf Oil Corp.* v. *Clayton,* 267 N.C. 15, 147 S.E. 2d 522 (1966); *American Bakeries Co.* v. *Johnson, supra; Commonwealth* v. *ACF Industries, Inc.,* 441 Pa. 129, 271 A.2d 273 (1970),[15] and cases cited in footnote 10, *supra.* The Montana Supreme Court's holding in the case at hand directly conflicts with these cases. Therefore, for this reason alone, this Court should act to resolve the conflict.

It is no coincidence that the Montana Department of Revenue has adopted the Multistate Tax Commission's position that *all* income is apportionable "business" income. Montana is not the commercial domicile of many multistate corporations. Adoption of a rule apportioning investment income away from its sources to a state in which the taxpayer has tangible property, payroll or sales will, on balance, subject a great deal more income to the state's tax than the state could reach through application of a proper rule. Most of the

[15] But cf. *Commonwealth* v. *Emhart Corp.,* 443 Pa. 397, 278 A.2d 916 (1971), *appeal dismissed,* 404 U.S. 981 (1971).

great commercial and industrial states, on the other hand, will continue to require that investment income be taxed at its source. For this reason it is futile to speculate whether Montana's system of extraterritorial taxation might somehow be valid if all states applied the same formula—that is, if the states of commercial domicile which have the recognized power to tax the investment income failed to do so.

No single formula will ever appeal to the self-interest of every state. States will continue to experiment with apportionments and allocations designed to maximize the amount of taxable income generated under each state's particular circumstances. Misallocation of income thus results, not as an unintended by-product of neutral formulae consistently applied, but as the necessary corollary of each state's action in pressing its jurisdiction to the furthest arguable limit. While this scramble may be viewed as a contest between states or regions—agricultural vs. industrial, consumer vs. producer, West vs. East—in actuality it is the multistate taxpayer who must pay tax on more than 100% of its income for the privilege of engaging in interstate commerce. It is this chaotic misallocation which requires the intervention of this Court, to define more clearly the limits of state taxing jurisdiction.

C. The So-Called "Combined Report" Theory

Regulations and practices of the Multistate Tax Commission call for use of the combined reporting theory.[16] Under this concept of taxation, the income of

[16] See, Commission Regulations IV, 2(b)(2) ("Application Article IV: Combined Report"), which is reproduced in Appendix B, Reply Memorandum of Appellants, *U. S. Steel Corp.* v. *Multistate*

a group of affiliated corporations earned in several states and countries is "combined" and subjected to taxation in those Compact states in which one of the affiliated corporations is present. Taxes are imposed on the apportioned overall income of the affiliated corporations without regard to whether the income being taxed was earned by a taxpayer subject to the jurisdiction of the Compact state.

The Multistate Tax Commission, pursuant to its regulations and practices, included the income of six U.S. and Canadian subsidiaries in Appellant's apportionable income, and Montana tax was assessed on such income. To the extent that combined reporting increased the tax which Appellant alone would have paid, the undeniable effect of the procedure is to tax part of the subsidiaries' income in Montana, despite the fact that the subsidiaries were *admittedly* not subject to Montana's taxing jurisdiction in their own right.[17] See J.S., App. E, pp. 62a-63a.

The argument of Montana—that the purpose of combination is not to tax the income of companies beyond the State's jurisdiction but to measure Appellant's Montana income more accurately—is mere sophistry. None of the subsidiaries carried on any business in Montana. It has not been shown that they con-

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Tax Commission, supra. Frederick Cappetta, the Audit Coordinator for the Commission, stated in Multistate Tax Commission, Seventh Annual Report, p. 56 (1974), that the Commission would continue to pursue the combined reporting concept in its audits.

[17] Compare this Court's June 24, 1977 holding that an assertion of in rem jurisdiction by Delaware in a derivative action lacked "minimum contacts" and violated the Due Process Clause. *Shaffer* v. *Heitner*, 53 L.Ed. 2d 683 (1977).

tributed in any way to Appellant's Montana operations, or that Appellant dealt with them at less than arm's length in transactions outside Montana. Because there has been no evidence that Appellant's ownership and control of the subsidiaries were used to shift income from Appellant to the subsidiaries through artificial business arrangements outside of Montana, Appellant cannot be required to pay tax on the reported income of its subsidiaries any more than it could be required to pay tax on the reported income of unrelated suppliers or customers with whom it had similar dealings.

Appellant's separate income was accurately reflected on its own tax returns. The additional income taxed through combined reporting belonged to its subsidiaries and was taxable by states other than Montana or, in the case of foreign subsidiaries, by the country in which it was derived.[18]

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[18] As pointed out in Miller, "State Income Taxation of Multiple Corporations and Multiple Businesses", 49 Taxes-The Tax Magazine 102 (1971), the accepted way of dealing with the problem of artificial or non-arm's length transactions between related parties is to recompute the income of each affiliate as though the transactions in question had been on an arm's length basis. Section 84-1508 of the Revised Codes of Montana gives Montana statutory authority to make such adjustments. Significantly, Montana did *not* attempt to invoke this statutory authority in the present case. Invocation of this remedy would not have been unduly burdensome, since the state has full access, under Treasury Dept., Internal Revenue Service, Disclosure of Official Information Handbook (IRM 1272) §§(12)52, (12)55:(5), Exhibit (12)00-1, 1 CCH Internal Revenue Manual [Administrative] pp. 2235, 2241, to information as to intercompany adjustments made by the Internal Revenue Service pursuant to Section 482 of the Internal Revenue Code of 1954, the corresponding provision of federal law. Instead, Montana went beyond the federal approach and beyond its own authority in its efforts to tax extraterritorial income.

The attempt by the Multistate Tax Commission and the Montana Department of Revenue to impose combined reporting requirements is particularly disturbing when, as in this case, the combination includes one or more corporations organized and operating in foreign countries, and thus has international as well as federal implications.[19] The disruptive effect of the combined report on interstate and foreign commerce is well illustrated by the recent testimony before the U.S. Senate Committee on Foreign Relations concerning the U.K.-U.S. Income Tax Treaty presently before the U.S. Senate for ratification, which treaty precludes the imposition of combined reporting on domestic enterprises controlled by U. K. residents.[20] For example, Assistant Secretary of the Treasury Laurence N. Woodworth noted that the combined reporting practices produced complaints from our treaty partners, violated the spirit of existing United States tax treaties, varied from internationally-accepted practices, produced possible multiple taxation by the states, and resulted in extraterritorial taxation by the states.[21] The U.S.-U.K. treaty demonstrates that the United King-

[19] The U. S. Treasury Department has received numerous requests from various nations seeking protection from combined reporting. See Report of the Department of State, June 8, 1976:

> "This method of assessment, which includes the burden of producing worldwide records of all of the affiliated companies, has raised many objections by our treaty partners and we are now seeking to deal specifically with this problem in our treaties." [2 CCH *Tax Treaties* ¶ 8103DC]

[20] Treaty Hearings, *supra*, n.3.

[21] *BNA Daily Report for Executives*, No. 140, J-10, at J-14 (July 20, 1977).

dom believes, and the United States agrees, that combined reports result in an improper extension of the taxing authority of the states.[22] It is unfortunate that this overreaching should have gone uncorrected to the point that the United Kingdom had to resort to such an extraordinary remedy as the treaty process. The treaty, however, will be of no direct benefit to many multistate taxpayers, who, like Appellant, must seek relief in the courts. It is for the benefit of these taxpayers, as well as of the federal system, that this Court is respectfully requested to exercise its jurisdiction and declare more fully the constitutional limits of state taxation.

D. Multistate Tax Commission Audit Status

This appeal provides a sequel to the *U.S. Steel* case, which was argued orally before this Court on October 11. 1977, and involves the issue whether congressional consent is required to the Multistate Tax Compact because of its actual and potential effects upon the national and international interests of the United States. The instant case not only raises the same constitutional issue as that involved in the *U.S. Steel* case but also shows in a concrete factual setting how the Multistate Tax Commission applied its invalid regulations to Appellant by means of an interstate tax audit conducted by the Commission itself under powers of subpoena.

[22] In discussing combined reports, counsel for the Multistate Tax Commission has represented to this Court that no audit ever conducted by the Commission touches on the subject matter of the U. K. treaty. *United States Steel Corp.* v. *Multistate Tax Commission, supra*, Transcript of Oral Argument, p. 28 (argued Oct. 11, 1977). The facts of this case demonstrate that counsel could not have intended to imply that the Commission had never combined U.S. and foreign affiliates.

Accordingly, it is very important for this Court to clarify the effect of the deep Multistate Tax Commission involvement in pending cases if this Court resolves the *U.S. Steel* case, *supra,* by holding—as we believe it should—that the Multistate Tax Compact is unconstitutional.

CONCLUSION

For all of the foregoing reasons, COST urges this Court to note probable jurisdiction in the present case and give plenary consideration to all three questions discussed in Appellant's Jurisdictional Statement.

Respectfully submitted,

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1028 Connecticut Avenue, N.W.
Washington, D.C. 20036

Attorney for the Committee on State Taxation of the Council of State Chambers of Commerce

APPENDIX

EXHIBIT A

STATE OF MONTANA

DEPARTMENT OF REVENUE
MITCHELL BUILDING
HELENA, MONTANA 59601

October 28, 1977

Multistate Tax Commission
and
Committee on State Taxation of the
Council of State Chambers of Commerce

Gentlemen:

ASARCO, Inc. has filed an appeal to the United States Supreme Court from the Montana Supreme Court decision in the American Smelting and Refining Company vs. Montana Department of Revenue of the State of Montana. We understand that the COST will file an amicus brief in support of the appellant's juriedictional statement. We also understand that Multistate Tax Commission will file an amicus brief in opposition to the appellant's jurisdictional statement. This will confirm that we consent to the filing of such briefs by COST AND MTC.

Yours very truly,
/s/ ROBERT W. CORCORAN
Robert W. Corcoran
Chief Tax Counsel

LAW OFFICES

HUGHES, BENNETT & CAIN
SUITE A - 406 FULLER AVENUE
HELENA, MONTANA 59601

October 28, 1977

Multistate Tax Commission

and

Committee on State Taxation of the
Council of State Chambers of Commerce

Gentlemen:

ASARCO, Inc. has filed an appeal to the United States Supreme Court from the Montana Supreme Court decision in the American Smelting and Refining Company vs. Montana Department of Revenue of the State of Montana. We understand that the Committee on State Taxation ("COST") and the Multistate Tax Commission (MTC) both respectively wish to file an amicus brief in support and in opposition of and to the appellant's jurisdictional statement in that case. This will confirm that we consent to the filing of such briefs by COST and MTC.

Very truly yours,
/s/ GEORGE T. BENNETT
George T. Bennett
of Counsel for ASARCO

FILED
DEC 26 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-653

ASARCO Incorporated (formerly
The American Smelting and Refining Company),
Appellant,

v.

MONTANA DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA,
Appellee.

On Appeal from the
Supreme Court of Montana

BRIEF OF THE MULTISTATE TAX COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEE'S MOTION TO DISMISS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-658

ASARCO Incorporated (formerly The American Smelting and Refining Company),
Appellant,

v.

MONTANA DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellee.

On Appeal from the Supreme Court of Montana

BRIEF OF THE MULTISTATE TAX COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEE'S MOTION TO DISMISS

I.
INTRODUCTORY STATEMENT

This brief is submitted by the Multistate Tax Commission (hereinafter referred to as the Commission) as

amicus curiae in support of Appellee's Motion to Dismiss. Both parties to this proceeding have consented to the filing of this brief.[1]

II.

STATEMENT OF INTEREST

The Commission is the official administrative agency of the Multistate Tax Compact (hereinafter referred to as the Compact) entered into currently by 19 states as full members, and by 13 states as associate members.[2]

The purposes of the Compact are to:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicate taxation.

In fulfillment of these objectives in the area of state income taxation of multistate businesses, Article IV of

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[1]See Exhibit A, pages 1a-2a of the Brief of the Committee on State Taxation of the Council of State Chambers as Amicus Curiae in Support of Appellant's Jurisdictional Statement.

[2]The current regular members are the states of Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, New Mexico, Nevada, North Dakota, Oregon, South Dakota, Texas, Utah and Washington.

The current associate members are the states of Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, Ohio, Oklahoma, Pennsylvania, Tennessee and West Virginia.

the Compact sets forth the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) promulgated by the National Conference of Commissioners on Uniform State Laws in 1957.[3] UDITPA apportions "business income" in accordance with the well recognized three factor apportionment formula of property, payroll, and sales, commented on by this Court in *General Motors Corp. v. District of Columbia*, 380 U.S. 553 (1965).

Article VII of the Compact permits the Commission to promulgate advisory rules and regulations concerning this Uniform Act. The Compact (Article VIII) also provides for joint audits at the request of member states to further implement uniform enforcement of the Uniform Act. In this manner, the Compact and the Commission have sought to substantially diminish potential problems of overtaxation or undertaxation of the income of enterprises carrying on business activities in two or more states or countries. The Commission is thus concerned with the effort of Appellant and C.O.S.T. to seek review in this Court of the Supreme Court of Montana's interpretation and application of the language of UDITPA which involves only a question of state law.[4]

The Commission is also concerned with Appellant's and C.O.S.T.'s position that the corporate form rather than business and economic substance control the constitutionality of state income tax laws; for that is all their position consists of when they argue that the uni-

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[3]Uniform Laws Annotated, Vol. 9a, p. 448 et seq.

[4]While Montana had not enacted the language of UDITPA in statutory form for the years in question, the Montana Supreme Court upheld the Appellee's regulations adopting the language of UDITPA as a reasonable implementation of Section 84-1503, R.C.M. 1947.

tary concept, as applied to a group of affiliated corporations ("combined reporting"), is unconstitutional.

The Commission is further concerned with Appellant's and C.O.S.T.'s unwarranted attacks on the Compact, the Commission and Montana's administration of its tax laws. These are political attacks based on statements of C.O.S.T.'s and Appellant's own self-serving choosing, which are completely unsupported. These attacks have nothing to do with this appeal.

III.

THE ARGUMENT

A. *INTRODUCTORY CONSIDERATIONS AND SUMMARY OF ARGUMENT.*

This is an appeal from the Montana Supreme Court. It is therefore important to note what was before the Supreme Court of Montana for resolution. The basic issue before the Montana Supreme Court was whether or not a "hybrid" method used by the Appellant to determine its Montana taxable income for the years in question constituted a correct interpretation of Section 84-1503, R.C.M. 1947. In reporting its income tax liability to Montana for the years in question, the Appellant first determined its total taxable income by deducting all of the expenses it deducted in arriving at federal taxable income. It then made certain state adjustments to federal taxable income and then deducted the gross amount of income derived from royalties, dividends, rentals, interest, and gains on the sale of stock from federal taxable income to arrive at apportionable income. For example, in regard to its rental properties, the Appellant deducted all of the rental expenses including taxes, depreciation and interest charges associated with its rental properties to arrive at federal taxable income and then

deducted for Montana income tax purposes the gross rental income. The Appellant then apportioned the net results of these adjustments and deductions by the three factor UDITPA formula to arrive at Montana taxable income. Appellant interpreted Section 84-1503, R.C.M. 1947 to permit this method of reporting. Appellant thus asserted that the Appellee had no authority under Section 84-1503, R.C.M. 1947 to require the Appellant to apportion all of its unitary income in accordance with the regulations of Appellee which adopted the unitary concept for the apportionment of income and employed the distinction between "business" and "nonbusiness" income as defined in Section 1(a) of UDITPA. Furthermore, the Appellant contended that the Appellee could not ascertain the Appellant's taxable income and the apportionment factors by the so-called "combined reporting" method.

The Montana Supreme Court, in answering these contentions of the Appellant, simply found that Section 84-1503, R.C.M. 1947 did not permit the Appellant to apportion a part of its income and "separately account" for part of its income. It further found that the Appellee had the authority to adopt regulations for the apportionment of the entire unitary income of the Appellant, including utilization of the "combined method" of reporting. Furthermore, in applying the UDITPA regulation language and the "combined reporting" method to Appellant, the Court determined as a matter of fact that (1) all of Appellant's income was income from its unitary business ("business" income); and (2) that Appellant was conducting a unitary business with six of its wholly owned subsidiaries.

In making its argument before the Supreme Court of Montana and other Montana tribunals, the Appellant did not argue that the UDITPA regulations of the Appel-

lee were unconstitutional in requiring the apportionment of "business" income. Furthermore, Appellant did not argue that "combined reporting" was unconstitutional. Rather, the Appellant argued that Appellee had no authority under Montana law to require full apportionment of business income and "combined reporting."

Appellant has sought to raise the constitutionality of the UDITPA distinction between business and nonbusiness income as applied by the Montana Supreme Court and the constitutionality of the "combined method" of reporting for the first time in the Montana Courts in its application for rehearing in the Montana Supreme Court.

Contrary to the argument of C.O.S.T. and Appellant, this appeal does not involve the validity of the Multistate Tax Compact which is before this Court for resolution in *United States Steel Corp., et al. v. Multistate Tax Commission et al.*, Docket No. 76-635, submitted October 11, 1977. Neither does it involve the validity of the Commission's joint audit program or its advisory regulations implementing the language of Article IV of the Compact (UDITPA). Thus, the only questions at issue which could possibly give rise to federal questions are the constitutionality of UDITPA as interpreted and applied by the Montana Supreme Court and the "combined report" method utilized by Appellee to compute Appellant's Montana tax liability. However, as indicated in Appellee's brief, these issues were not timely raised for consideration either by the Montana Supreme Court or this Court on appeal.

Inasmuch as decisions of this Court have all upheld the apportionment of the unitary income of a trade or business by the well recognized three factor formula contained in UDITPA, Appellant has not otherwise raised a substantial federal question.

B. CONTRARY TO APPELLANT'S AND C.O.S.T.'S ARGUMENT, THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT WHICH REQUIRES THE APPORTIONMENT OF ALL BUSINESS (UNITARY INCOME) OF A MULTISTATE TAXPAYER IS CONSTITUTIONAL AND VALID IN EVERY RESPECT.

It is well settled that the states may apportion the unitary income of a unitary business by application of the generally recognized three factor apportionment formula [*General Motors Corp. v. District of Columbia, supra*, 380 U.S. 553 (1965); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942)]. It is equally well settled (1) that one who attacks a formula of apportionment carries a distinct burden of showing by "clear and cogent evidence" that it results in extraterritorial values being taxed *(Butler Bros. v. McColgan, supra)*; and (2) that an apportionment formula that arrives at a rough approximation of income attributable to a particular state is constitutional (*International Harvester v. Evatt*, 329 U.S. 416, 422 (1947).

There is no question but what Appellant was conducting a unitary business in Montana and that its income was subject to apportionment. As specifically noted by the Montana Supreme Court:

> "In 1962, ASARCO recognized that its business was unitary in nature and that it could no longer use separate accounting for its income. Pursuant to Section 84-1503 it requested permission from DOR [Department of Revenue of the State of Montana] to change from separate accounting to the unitary method of accounting. Permission was granted by DOR and a 'hybrid' system of reporting income was instituted. Under this hybrid system, all but a negligible amount of total company income from

rents, royalties, dividends, interest and sales of tangible and intangible properties was allocated to sources outside of Montana. After deductions for the allocated income, ASARCO's operating net income was apportioned to Montana sources by the use of a three factor formula." (Material in brackets added Appellant's Appendix p. 3a)

The constitutional question then is whether or not the Appellant can apportion a part of its unitary income and segregate the balance of its unitary income by "sources" (either by situs or corporate entity) and separately account for that balance.[5] This is indeed a novel method of attribution of income for state income tax purposes. It has never been supported in any manner by any decision of this Court.

The Montana regulations which adopt the language of UDITPA provide for the specific allocation of "nonbusiness" income and the apportionment of "business" income under the three factor UDITPA formula. Business income is there defined in Section 1002(a) as "income from any transactions and activity in the regular course of the taxpayer's trade or business and includes income

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[5]As indicated on ASARCO's income tax returns to Montana for the years in question, the following constitutes its federal taxable income, its allocated nonbusiness income and income subject to apportionment:

Year	*Federal Taxable Income*	*Allocable Nonbusiness Income*	*Apportionable Income*
1967	60,572,768	45,169,221	15,358,547
1968	62,531,929	62,548,620	(16,291)
1969	92,480,382	76,869,974	15,610,408
1970	115,219,427	115,584,872	(365,445)

(Figures in parenthesis are negative figures.)

Except for a neglible amount, all the nonbusiness income was purported allocated to states other than Montana.

from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." The Commission regulations, which are criticized by C.O.S.T., are contained in the Commission Reg. IV.1.(a)[6] which reads in pertinent part:

> "Income of any type or class or from any source is business income if it arises from transactions and activities occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is 'business income' or 'nonbusiness income' is the identification of the transactions and activity which are the elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, the trade or business."[7]

Notwithstanding the issue as framed by the Montana Supreme Court, as we understand Appellant's and C.O.S.T.'s argument, it is their contention that UDITPA is unconstitutional to the extent it requires apportionment of "business" income which is not derived from so-called trading profits and which can be "sourced" by property tax situs concepts. As will be demonstrated

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[6]Seventh Annual Report of the Commission, June 30, 1974, p. 64.

[7]While the advisory regulations of the Commission interpreting this language which is contained in Article IV of the Compact was not considered by the Montana Supreme Court and not adopted by Montana for the years in question, it is significant to note that those regulations are not at variance with the definition of "business" income as set forth in Section 1(a) of Article IV of the Compact and UDITPA.

herein, we do not believe this raises a substantial federal question.

Starting with the early utility property tax cases, this Court has uniformly upheld the apportionment of the entire properties or income attributable to a unitary business by an apportionment formula which has not been demonstrated by the taxpayer by clear and cogent evidence to tax extraterritorial income or values.

In *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), this Court summarized the holdings of its prior utility property tax decisions pertaining to unitary reporting as follows:

> "As to railroad, telegraph and sleeping-car companies, engaged in interstate commerce, it has often been held by this Court that their property in the several states through which their lines or business extended might be valued as a unit for purposes of taxation, taking into consideration the uses to which it was put and all the elements making up aggregate value, and that a portion of the whole fairly and properly ascertained might be taxed by the particular state, without violating any federal restrictions. [Cases cited.] The valuation was, thus, not confined to the wires, poles, and instruments of the telegraph company; or the roadbed, ties, rails and spikes of the railroad company; or the cars of the sleeping-car company, but included the proportionate part of the value resulting from the combination of the means by which the business was carried on, a value existing to an appreciable extent throughout the entire domain of operation." (165 U.S. 220, 221)

In the *Adams Express Co.* case, this Court went on to hold that all of the property of the express company which was used in its trade or business, including its intangible assets, were properly subject to apportionment

for ad valorem property tax purposes. Furthermore, this Court there held that:

> "Presumptively, all the property of the corporation or company is held and used for the purposes of its business, and the value of its capital stock and bonds is the value of only that property so held and used." (165 U.S. 227)

This Court therefore concluded in the *Adams Express Co.* case that the total market value of the stock of the express company could be taken into consideration in valuing its properties within the taxing state, even though its intangibles had a specific situs outside the taxing state.

The foregoing conclusion of this Court in the *Adams Express Co.* case was vigorously opposed by the Company in a lengthy petition for hearing. The Court granted the rehearing and issued its opinion in accordance therewith in *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185 (1897). In the rehearing, the Express Company objected to including its intangible properties as part of the value subject to apportionment and taxed in part by the State. In holding that the intangible properties (which constituted three-fourths of the total value of the Express Company's capital stock) could be subject to taxation by the apportionment method, this Court reasoned as follows:

> "Where is the situs of this intangible property? Is it simply where its home office is, where is found the central directing thought which controls the workings of the great machine, or in the state which gave it its corporate franchise; or is that intangible property distributed wherever its tangible property is located and its work is done? Clearly, as we think, the latter. Every state within which it is transacting business and where it has its prop-

erty, more or less, may rightfully say that the $16,000,000 of value which is possesses springs not merely from the original grant of corporate power by the state which incorporated it, or from the mere ownership of the tangible property, but springs from the fact that the tangible property it has combined with contracts, franchises and privileges into a single unit of property, and this state contributes to that aggregate value not merely by the separate value of such tangible property as is within its limits, but its proportionate share of the value of the entire property.

"It may be true that the principal office of the corporation is in New York, and that for certain purposes the maxim of the common law was '*Mobilia personam sequuntur*,' but that maxim was never of universal application, and seldom interfered with the right of taxation. *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 22. It would certainly seem a misapplication of the doctrine expressed in that maxim to hold that by merely transferring its principal office across the river to Jersey City, the situs of $12,000,000 of intangible property for purposes of taxation was changed from the state of New York to that of New Jersey." (166 U.S. 223-224)

It is thus clear that the *Adams Express Co.* cases and cases relied on therein clearly establish a unit rule or unitary concept for state tax purposes and permit a state to determine the instate privilege, property or income by reference to the total privileges, property or income of the multistate business if there is a unitary relationship between the instate activities or property of the business and its total activities or properties everywhere. They also establish the proposition that all of the properties or

income of a unitary business are subject to a reasonable rule of apportionment. These cases also support the principle that an apportionment formula is deemed to be reasonable in result and the burden is upon the taxpayer to establish otherwise.

In the income tax case of *Butler Bros. v. McColgan*, *supra*, this Court noted:

"At least since *Adams Express Co. v. Ohio*, 165 U.S. 194, this Court has recognized that unity of use and management of a business which is scattered through several states may be considered when a state attempts to impose a tax on an apportionment basis." (315 U.S. 508)

This Court therein upheld the validity of the three factor apportionment formula against the entire unitary income of Butler Bros. In the language of the Court:

"We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that these factors may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of the *total unitary income*,' so as to allocate to California its just proportion of the profits earned by Appellant from this unitary business. And no showing has been made that income unconnected with the unitary business has been used in the formula." (Emphasis added) (315 U.S. 509)

It is thus submitted on the basis of authorities such as the *Adams Express Co.* cases and *Butler Bros. v. McColgan*, and cases of like import, that there is absolutely no merit to Appellant's and C.O.S.T.'s argument that only the state of commercial domicile has the constitutional right to include income from intangible properties in apportionable income. In fact, if intangible proper-

ties and income from such intangibles are used in connection with and are integral parts of a taxpayer's trade or business operations, it would appear that the commercial domicile has no valid constitutional basis for attributing the entire income from such properties to it. The commercial domicilary state certainly has no greater claim to tax such income than the legal domicile, the place where the intangibles are physically located, or states in which the intangibles have acquired "a business situs." In fact, the apportionment of unitary income from intangibles to where a unitary integrated business carries on its trade or business activities reflected by its property, payroll and sales is nothing more nor less than a modern application of the "business situs" concept.[8]

It is significant to note that *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), cited on page 18 of C.O.S.T.'s brief, specifically noted that situs concepts utilized for property tax purposes were not controlling for attribution of income for income tax purposes. It there stated:

> "The tax is not on the net profits of a unitary enterprise demanding a method, not intrinsically arbitrary, of making an apportionment among different jurisdictions with respect to the processes by which the profits are earned. [Citations omitted] Such a tax on net gains is distinct from an ad valorem property tax on the various items of property

[8]In fact, it may be necessary, as found by the Supreme Court of Minnesota in *Marshall-Wells Co. v. Commission of Taxation*, 220 Minn. 458, 20 N.W.2d 92 (1945), that intangibles be utilized in the business operations of the taxpayer before the intangibles or income therefrom can be taxed at the commercial domicile. As noted by the Court in *Marshall-Wells Co.*, this certainly was found to be true in *Wheeling Steel Corporation v. Fox*, 298 U.S. 193 (1936).

> owned by the corporation and laid according to the location of the property within the respective tax jurisdiction . . ." (298 U.S. 212)

In determining the importance of investments to the overall business operations, this Court aptly noted in *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911):

> "Nor can it be justly said that investments have no real relationship to the business transacted by a corporation. The possession of large assets is a business advantage of great value; it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige." (220 U.S. 166)

Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939), upheld the apportionment of an excess of $23,000,000 of the capital of Ford Motor Company to Texas when there was only approximately $3,000,000 of its assets physically located in Texas. Significantly, this Court stated:

> "In a unitary enterprise, property outside of the state necessarily affects the worth of the privilege within the state. Financial power inherent in possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine. For this reason, it is held that an entrance fee may be properly measured by capital wherever located. The weight, in determining the value of the intrastate privilege, given the property beyond the state's boundaries, is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state." (308 U.S. 336)

There is nothing in the record to indicate that the Appellant's so called investments and income derived therefrom were not utilized by Appellant in its overall business operations. The record establishes otherwise. Furthermore, Appellant does not contend that its investment properties and income derived therefrom were not part of its unitary operations (Juris. St., pp 12-16) and did not contribute to its overall operations including those conducted in Montana for the years in question. Furthermore, there is nothing in the record to indicate and Appellant does not argue that the three factor UDITPA apportionment formula arrives at an unreasonable result in apportioning a small part of its entire taxable income to Montana.

Contrary to C.O.S.T.'s argument (C.O.S.T.'s brief, page 18), and Appellant's argument (Juris. St., p. 12) no court has ever limited constitutional formulary apportionment to the *trading profits* or operating income of a business. In fact, the cases have universally held that the income of a unitary business which is connected with business activities carried on in part within a taxing state may be subject to formulary apportionment even though derived from intangible properties. In *International Harvester v. Department of Taxation*, 322 U.S. 435 (1944), and *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435 (1940), this Court upheld the apportionment of income from dividends against the payor corporation based on its instate activities. In *Montgomery Ward & Co. v. Commissioner of Taxation*, 276 Minn. 479, 151 N.W. 2d 294 (1967), and *Great Lakes Pipeline Co. v. Commissioner of Taxation*, 272 Minn. 403, 138 N.W.2d 612 (1965), app. dism'd 384 U.S. 718 (1966), the Court held that interest income was business income subject to apportionment. In *F. W. Woolworth Co. v. Director of Division of Taxation*, 45 N.J. 466, 213 A.2d 1 (1965);

Gulf Oil Corp. v. Morrison, 120 Vt. 324, 141 A.2d 671 (1958); and *F. W. Woolworth Co. v. Commissioner of Taxes*, 130 Vt. 544, 298 A.2d 839 (1972), the Courts held that dividend income was subject to apportionment either as business income or as a part of the unitary income of the payee corporation. In *Sperry & Hutchinson Co. v. Department of Revenue*, 270 Or. 329, 527 P.2d 729 (1974), the Court held that interest income used in the trade or business of the taxpayer was subject to apportionment under UDITPA. As indicated in *Appeal of W. J. Voit Rubber Co., May 1947 C.C.H. Cal. Tax Rep. para. 202-435*, and cases cited therein, the California Board of Equalization has always held that income from a unitary business, whether from intangible properties or otherwise, is subject to formulary apportionment. *In Re Goodyear Tire & Rubber Co. Corporate Income Tax 1966, 1967, 1968*, 133 Vt. 132, 335 A.2d 310 (1975), the Court upheld the apportionment of dividend income.

The Minnesota Supreme Court in *Montgomery Ward & Co. v. Commissioner of Taxation, supra*, analyzed its holding in *Great Lakes Pipeline Co. v. Commissioner of Taxation, supra*, in part as follows:

> ". . . intangible property is employed in a business if the corporation owning the intangible property holds it as a means of furthering the business operation of which a part is located within the territorial confines of this state.
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> ". . . the evidence established that the intangibles held by Great Lakes Pipeline Co. were a part of one unitary business operation (i.e., the business of transporting refined petroleum products by pipeline) because (a) the business activities produced the income used to purchase the intangibles; (b) the in-

come from the intangibles was commingled with the business earnings of the corporation; the securities were at all times carried as current assets; and the same financial officers controlling the affairs of the Pipeline Company were responsible for the investments involved; (c) *the increase, gain, and principal of these intangibles was used entirely to pay various expenses and obligations of the business activities.*" (151 NW 2d 296)

In referring to the test to be utilized in determining whether income is utilized in the overall business operations, the court in *Montgomery Ward & Co. v. Commissioner of Taxation, supra*, stated:

"But where the fund so held is not set aside as a reserve for future expansion and made unavailable for current operating expense; where the management of the investment and reinvestment of corporate funds in the intangibles is entrusted to the corporate officers who manage the principal business; where the income from the intangibles is commingled with ordinary business income; and where the operating expenses of the business enterprise are paid generally from such commingled funds, the taxpayer's burden of establishing that the intangibles were not employed in the principal business would seem to be an extremely difficult one." (151 NW 2d 296-297)

Nor is there merit to C.O.S.T.'s argument that the inclusion of income from intangible properties in apportionable income results in taxation of more than 100% of income. There is absolutely no proof in this case nor assertion by the Appellant that any of the income apportioned to Montana has been specifically allocated to and taxed by any other state. To our knowledge no state specifically allocates the business income of a unitary business. Thus, C.O.S.T.'s multiple taxation argument is

pure conjecture not supported by any facts. This is not to suggest that the states have been consistent in the apportionment or specific allocation of items of income, including those from intangible properties. Because of the problems associated with differing practices of the states in allocating or apportioning various items of income, the Willis Subcommittee recommended full apportionment of all income.[9]

Furthermore, C.O.S.T.'s assertion that all income from intangible properties has traditionally been allocated to the commercial domicile for state income tax purposes (C.O.S.T.'s Brief pp. 12-13) is specifically refuted by the Willis Report. Volume 1 of that Report[10] deals with the problem of specific allocation of income and deductions therefrom by state practices at the time of the Report. The Report noted on page 198:

"On the basis of the methods which they used to determine what income is specifically allocable, the states may be divided into three groups: (a) those which rely solely on an itemization of the particular types of income to be specifically allocated; (b) those which distinguish between business income and nonbusiness income; and (c) those which distinguish between unitary business income and other income."

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[9]The Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary House of Representatives, House Report No. 952, 89th Cong., 1st Sess., p. 114.

[10]Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary House of Representatives, 88th Cong., 2nd Sess., HR 1480 (1964), pp. 197-232.

In an Indiana survey,[11] in answer to the question, "Does your State (ever) include dividends in the apportionment base?" 31 states answered "yes."

This Court in *Curry v. McCanless*, 307 U.S. 357 (1939), rejected the situs test for a determination of the power of a state to tax intangibles under the due process clause. It there simply noted that more than one state could give benefits and privileges concerning intangibles which gave rise to taxing jurisdiction.

It is therefore respectfully submitted that there is no shown threat of double taxation of constitutional infirmities in including all of Appellant's unitary income, including income from intangibles, in income subject to apportionment in part to Montana.

C. A DETERMINATION OF APPELLANT'S MONTANA INCOME TAX LIABILITY BY "COMBINING" THE INCOME AND APPORTIONMENT FACTORS OF APPELLANT AND SIX SUBSIDIARY CORPORATIONS WHICH CONDUCTED A UNITARY BUSINESS WITH APPELLANT DOES NOT RAISE A SUBSTANTIAL FEDERAL QUESTION OR DENY THE APPELLANT ANY CONSTITUTIONAL RIGHTS.

The only question in regard to "combined reporting" is whether or not tax consequences should be different if a unitary trade or business is carried on under one cor-

[11]The State of Indiana conducted a survey to determine state progress towards uniformity. It published the results in a report entitled, "Results of a Survey of the Uniformity of State Tax Laws by the State of Indiana," (dated February 15, 1977 and reproduced in full as Supplemental A to the Appellee's Brief in *U. S. Steel Corp., et al. v. Multistate Tax Commission, et al.*, S. Ct. Docket No. 76-635.)

porate umbrella or several corporate umbrellas. If Corporation A manufactures a product which it sells to a sales subsidiary Corporation B and Corporations A and B are so interrelated in their business affairs that the separate profits of Corporation A cannot be determined apart from Corporation B and vice versa, it is perfectly logical and necessary to combine Corporations A and B to determine the true income of either Corporation A or B. This is the sum and substance of combined reporting. It is simply an accounting device to determine the true apportionable income of any member of an affiliated group conducting a unitary enterprise with other members of an affiliated group. For example, in *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924), this Court permitted apportionment between a corporation manufacturing ale in England and selling it in New York. Under the combined report method, it would make no difference in computing the New York tax attributable to New York sales activity if such activity were carried on by a sales subsidiary in New York or directly by the parent. Thus, the only question posed by "combined reporting" is whether the corporate shell game or business and economic reality should control tax consequences. Stated otherwise, should form control over substance? Under "combined reporting," substance and not form controls.

The Supreme Court of California, in upholding "combined reporting" did so because it could not justify a different result in *Edison-California Stores v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1947) from the result it arrived at in *Butler Bros. v. McColgan*, 17 Cal.2d 664, 111 P.2d 334, aff'd 315 U.S. 501 (1942), simply because in the *Edison Stores* case the business activity was carried on by a parent and subsidiary corporations and

in *Butler Bros.* is was carried on through divisions of the same corporation.[12]

The unitary concept within the "combined reporting" context is directed to the same problem that was before this Court in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920) wherein this Court noted:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sales in another state. . . . The legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." (254 U.S. 120, 121)

In the *Underwood Typewriter Co.* case, would the result have been different if a parent corporation had conducted the manufacturing operation in Connecticut and a sales subsidiary had conducted the sales activities in another state? We think not.

The need for "combined reporting" can be illustrated by an actual example of a multinational corporation conducting unitary operations in Canada and Idaho through two subsidiary corporations. The Canadian subsidiary processes pulp used for the manufacture of paper by the American subsidiary. The pulp is transported from the Canadian subsidiary to the American subsidiary by a pipeline crossing international boundaries. Under these circumstances, it is impossible to separate the profits of the Canadian subsidiary from

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[12]Furthermore, in the application of the unitary concept to a group of corporations ("combined reporting"), it makes no difference whether the affiliated group of corporations includes some foreign corporations or wholly domestic corporations.

that of the American subsidiary because the profits of the two corporations from the manufacture of pulp and paper products were earned by a series of transactions beginning in Canada and ending in sales. Thus, logic dictates that "combined reporting" be utilized to determine the profits of either of these two subsidiaries.

It is interesting to note that, though C.O.S.T. argues that "combined reporting" is unconstitutional, it admits that "If the amount of in-state income depends on accounting hypotheses or on an assumed division of income between branches of an integrated business, this Court justifiably refrained from intervening on the side of the corporate taxpayer simply because its calculation of instate income varies from that of the taxing authorities." (C.O.S.T. Br., p. 18). Yet, by arguing that "separate accounting" between members of a group of affiliated corporations, conducting a unitary business, should control tax consequences, C.O.S.T. is really asking this Court to intervene on the side of corporations based upon accounting hypotheses or an assumed division of income between branches of an integrated business simply because these branches are separately incorporated.

The constitutionality of "combined reporting" is supported by the decisions of this Court permitting the apportionment of the unitary income of a unitary business and the early utility property tax cases.

In the utility property tax cases it made no difference in applying the unit rule of valuation whether the utility system was owned and operated by a group of affiliated corporations or by a single corporation. In *Cleveland et al. Railway Co. v. Backus*, 154 U.S. 439 (1893), the Court rejected separate accounting for that part of a railway system which was located in the taxing state.

Apparently, several separate corporations were involved but were a part of a single system of operation. No question was raised that the separate corporate entities should be assessed separately.

In *Southern Railway Co. v. Kentucky*, 274 U.S. 76 (1927), as indicated by the dissenting opinion therein and by *Commonwealth v. Southern Railway Co.*, 193 Ky. 474, 273 S.W. 11 (1921), and *Southern Railway Co. v. Commonwealth*, 204 Ky. 388, 264 S.W. 840 (1924), this Court had before it the question of the valuation of the franchise of a railroad system where the instate railroad was owned by an out-of-state parent that operated the system. The sole question at issue was whether or not Kentucky had reasonably apportioned to Kentucky the franchise value attributable to the parent as a result of the subsidiary's presence in Kentucky. This Court assumed that the apportionment of a part of the parent's franchise value to Kentucky was proper since the out-of-state parent and the Kentucky subsidiary were part of a unitary utility system.[13]

In *Commonwealth v. Southern Railway Co., supra*, the Court simply held that the parent was present in Kentucky since the subsidiary was operated as its agent and therefore Kentucky could tax a reasonable proportion of the parent's franchise value.

Contrary to Appellant's and C.O.S.T.'s argument, a "combined report" does not subject to taxation a combined member of an affiliated group which is not conducting business in deriving income from the taxing state. "Combined reporting" is nothing more nor less

[13]It relied on *Southern Pacific Terminal Co. v. Commerce Commission, et al.*, 219 U.S. 498 (1911), and *Chicago-Milwaukee & St. Paul Railway Co. v. Minneapolis Civic and Commerce Assoc.*, 247 U.S. 490 (1918), in support of its decision.

than an accounting method to determine the true income and proper apportionment of the corporation subject to tax. For example, if Corporation A conducts a unitary business with its subsidiary Corporation B, to determine the income tax liability of either Corporation A or B, if their operations are integrated and unitary, these corporations are treated as conducting a single business and are taxed accordingly. Thus, after eliminating transactions between Corporations A and B, their combined income and combined apportionment factors are used to determine the income tax liability of either Corporation A or B. If Corporation A is present in the taxing state and Corporation B is not, Corporation A would be the sole taxpayer. No effort is made in any way to subject Corporation B to tax. If the combined income of Corporations A and B is $100,000 and ten (10%) percent of the combined activities of Corporations A and B are in the state as the result of Corporation A's activities there, Corporation A would be liable to the taxing state on ten percent of the combined income or $10,000. Corporation B would not be subject to tax in any manner whatsoever.

It is therefore respectfully submitted that the "combined reporting" issue, which the Courts have construed as an application of the unit or unitary rule of taxation, does not raise a substantial federal question.

D. AN EXAMINATION OF THE OPINION OF THE SUPREME COURT OF MONTANA INDICATES THAT THIS APPEAL INVOLVES ONLY AN INTERPRETATION AND APPLICATION OF SECTIONS 84-1503 AND 84-1508 R.C.M. 1947 PERTAINING TO THE AUTHORITY OF THE APPELLEE TO APPORTION THE UNITARY INCOME OF THE APPELLANT FOR MONTANA CORPORATE FRANCHISE TAX PURPOSES.

Notwithstanding the arguments of Appellant and C.O.S.T. to the contrary, the only justiciable issues decided by the Supreme Court of Montana are (1) the authority of Appellee to adopt the Montana regulations 1001-1020 (Chapter 10) employing the unitary concept and the UDITPA distinction between "business" and "nonbusiness" income for the division of income; (2) what income of Appellant was properly classified as "business" income from its unitary operations; (3) whether the Montana statute permitted Appellant's income to be determined by "combined reporting"; and (4) whether the Appellee and six of its wholly owned subsidiary corporations were conducting a unitary business for "combined reporting" purposes.[14]

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[14]As heretofore indicated, since "combined reporting" to Montana actually reduced the Appellant's Montana income tax liability for the years in question, it is questionable whether the Appellant had standing to object to the "combined reporting" method of determining its income tax liability. Certainly, in order to have standing to raise the "combined reporting" issue as a constitutional issue, the Appellant must show actual harm to it by the Appellee's use of "combined reporting" to determine Appellant's Montana taxable income. Appellant attempts to circumvent the application of this rule by asserting that "combined reporting" increased its tax liability for two years and failed to indicate that the decreased tax liability for the other years involved in the audit more than offset any such increase (Jurs. St., p. 18, footnote 6).

In resolving these questions, the Supreme Court of Montana held (1) that the regulations which adopted the language of UDITPA were a proper interpretation and application of Section 84-1503 R.C.M. 1947; (2) that all of the Appellant's income was "business" income subject to apportionment; (3) that Section 84-1503 R.C.M. 1947 permitted the Appellee to determine the Appellant's income tax liability to Montana by the "combined reporting" method of accounting; and, (4) that Appellant and its six combined subsidiary corporations were conducting a unitary business.

In resolving the business income issue, the Court stated as follows:

> "The regulations are clear and simple. All business income is apportionable and nonbusiness income is allocated to source. ASARCO argues that certain items of income listed above are nonbusiness income and therefore properly deductible from apportionable net income. This contention is incorrect.
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> "The regulations state that business income includes income derived from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operation. After an in-depth examination of the income in question, we find this income is derived from sources that are integral portions of its business. This finding is in direct conflict with the district court's finding of fact which state this income is nonbusiness income. The test of whether this income is in reality business or nonbusiness income is a matter of statutory interpretation. We feel therefore that the finding of the district court is in error. We are confronted herein with a conclusion of law, rather than a finding of fact. Listed below are examples of

the relationship of this alleged nonbusiness income to ASARCO." Appellant's Appendix pp. 10a-11a.

The Court then found as a matter of fact that all of the income of ASARCO was associated with its trade or business operations and constituted an integral part thereof and therefore was properly classified as business income and subject to apportionment.

In regard to the "combined reporting" issue, after reviewing some of the facts pertaining to the relationship of Appellant's activities to the six wholly owned subsidiary corporations combined with Appellant, the Montana Supreme Court held that the business operations of the Appellant and its six combined subsidiary corporations was unitary. In arriving at this conclusion, it relied upon the Oregon Supreme Court decisions in *Coca-Cola Co. v. Department of Revenue*, 271 Or. 517, 533 P.2d 788 (1975), and *Zale-Salem, Inc. v. Tax Commission*, 237 Or. 261, 391 P.2d 601 (1964).

An examination of the briefs and arguments in this cause and the opinion of the Montana Supreme Court reveals that this case does not involve any question concerning the validity of the Multistate Tax Compact, the Commission's joint audit program or the advisory rules and regulations of the Commission. Furthermore, no constitutional issues, except by application for rehearing, were ever raised in the appellate proceedings below. Thus, these issues are not properly before this Court and are apparently raised here by Appellant and C.O.S.T. to divert attention from the real and limited issues here involved which in no way raise any substantial federal question.

Many of the arguments of C.O.S.T. in their amicus brief are merely a rehash of some of the arguments presented by the Appellants in the *U. S. Steel et al. v. Multi-*

state Tax Commission, et al., case, *supra*, now pending before this Court. The Appellees' brief in that cause places such arguments in their proper perspective.[15]

There is absolutely nothing in the record in this cause to indicate that the Commission's regulations pertaining to Article IV of the Compact (UDITPA) were involved. No brief of either party nor none of the decisions of the lower tribunals mentioned anything concerning the Compact or the Commission except for recital of the fact that the Commission audited the Appellant's books and records on behalf of the state of Montana and other states. In conducting such audit, the Commission was bound to follow the rules and regulations and the laws of Montana and the specific guidelines and instructions furnished the Commission auditors by the Appellee. Furthermore, the joint audit of Appellant's books and records on behalf of Montana and other states was conducted with the consent of Appellant and did not in any

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[15]In fact, as indicated in Appellant's brief in opposition to the Commission's request to file an amicus brief in the Montana Supreme Court, the Appellant asserted:

> "It is true that the audit which formed this basis of this litigation was conducted by the Multi-State Tax Commission. *But this act has no bearing whatsoever on the issue on appeal herein.* There never was any question in this case as to the audit information. Thus, the issue on appeal does not relate to the validity of the mechanics of the audit. Rather, the issue on the Department's appeal concerns the time at which the principals of UDITPA became effective in Montana. This issue, ASARCO submits, is solely and exclusively one of Montana law, in which the Multi-State Tax Commission has not one bit of interest with respect to which there is no need whatsoever to 'uniform interpretation and application by the member states' of the Multi-State Tax Commission." (Emphasis supplied; 80a-81a)

We submit that this is a correct statement except that the Montana Regulations involved an interpretation of Section 1(a) of UDITPA.

way involve the exercise of any subpoena or other authority on behalf of the Commission. Thus, C.O.S.T.'s and Appellant's effort to treat this appeal as one involving the validity of the Compact, the Commission, its joint audit program or its advisory rules and regulations is totally unwarranted and completely unsupported by the record.

IV.

CONCLUSION

The Montana Supreme Court had before it for resolution only state law questions. It did not have before it for consideration any questions concerning the Compact, its Commission or its joint audit program. It did not have before it for consideration any contention that the classification of all of Appellant's income as apportionable business income transgressed any constitutional limitations. Neither did it have before it any contention that "combined reporting" was unconstitutional. The only issues before the Montana Supreme Court were the interpretation of Montana law, the application of the language of UDITPA as a regulation and "combined reporting" for a determination of the Appellant's properly apportionable income to Montana. Furthermore, inasmuch as there is no question but what the well-recognized three factor apportionment formula is constitutional in apportioning all of the unitary income of a unitary business, whether conducted in a single or a multiple corporate form, it is crystal clear that there could not possibly be any substantial federal question raised in this cause. For, if anything is settled by the decisions of this Court, it is that unitary income of a trade or business can be apportioned by the well-recognized three factor UDITPA apportionment formula.

This is particularly true when a taxpayer, which is the case at bar, has failed to establish by "clear and cogent evidence" that the application of an apportionment formula results in the taxation of extraterritorial values. The fact, relied upon by Appellant (Juris St., p. 14), that Appellant's income tax liability was increased elevenfold by apportionment of its unitary income by the UDITPA three-factor formula does not establish that the formula arrived at an unreasonable result. It simply demonstrates the invalidity of Appellant's "hybrid" method of reporting its income tax liability to Montana for the years in question.

It is therefore respectfully submitted that this Court dismiss the appeal.

Respectfully submitted,

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